Supreme Court, U.S.
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In the Supreme Court of the United States

SHERMAN PARK APARTMENTS, ET AL.,

PETITIONERS,

V.

UNITED STATES

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether, in a comprehensive program designed and implemented by HUD to encourage the construction and operation of low-income housing, memorialized in each instance by a series of interlocking documents specifically prescribed by HUD, the Federal Circuit erroneously extinguished the rights of hundreds of private developers by refusing to construe the writings together as part of a single, integrated transaction for purposes of interpreting HUD's contractual obligations.

2. Whether the Federal Circuit misconstrued fundamental principles of law and this Court's decision in *United States v. Winstar Corp.*, 518 U.S. 839 (1996), when it held that Congress can willfully repudiate a material promise that HUD made to induce these private developers to construct and operate low-income housing -- a promise Congress acknowledged to be a binding contractual obligation -- so long as the specific paper documenting that promise was not executed by HUD as a party or expressly incorporated into writings executed by HUD.

3. Whether the Federal Circuit misconstrued fundamental principles of law and this Court's decision in *Winstar* when it held that HUD's commitment to provide mortgage insurance "under the . . . provisions of [Section 221(d)(3) or Section 236, as applicable] of the National Housing Act, and the Regulations thereunder now in effect" gave the developers no enforceable rights, because the Regulations then in effect, by their terms, could be amended by HUD.

PARTIES TO THE PROCEEDING

The petitioners are Sherman Park Apartments, Independence Park Apartments, Pico Plaza Apartments, and St. Andrews Gardens. The respondent is the United States.

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PETITION FOR WRIT OF CERTIORARI

Sherman Park Apartments, Independence Park Apartments, Pico Plaza Apartments, and St. Andrews Gardens respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Federal Circuit.

OPINIONS BELOW

The opinion of the Court of Appeals (App., *infra*, 1a-37a) is recorded at 162 F.3d 1123. The order denying a petition for rehearing and suggestion for rehearing *in banc* (*id.* at 159a-160a) is unreported. The three opinions of the Court of Federal Claims (*id.* at 39a-158a) are reported at 33 Fed. Cl. 196, 37 Fed. Cl. 79, and 38 Fed. Cl. 64.

JURISDICTION

The judgment of the Court of Appeals was entered on December 7, 1998. A petition for rehearing and suggestion for rehearing *in banc* was denied on March

11, 1999. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATEMENT

> Twenty-some years ago, the Department of Housing and Urban Development began entering into contracts with owners and developers where in exchange for an interest rate subsidy, the property owners agreed to hold hundreds of thousands of units open as low-income housing units.
>
> Under the terms of the contracts, the owners were allowed after 20 years to prepay the mortgages, and at that point to opt out of the HUD programs. When these contracts began to reach their 20-year maturity, somebody got nervous. In fact, it appears they got so nervous that they just could not stand the idea that maybe somebody would actually opt out of the contracts, and that therefore it would be a good idea to enact a moratorium on the right of the owners to prepay their mortgages.
>
> In fact, that is exactly what happened in the Low-Income Housing Preservation Act of 1987. There are many of us in this Chamber and elsewhere who have doubts as to the advisability . . . and the constitutionality of that.
>
> . . .
>
> . . . These poor devils that entered into these contracts 22 or 23 years ago probably had the mistaken notion that the Federal government was going to honor its word.

136 Cong. Rec. 26,382-83 (1990) (statement of Senator Armstrong).

Notwithstanding Senator Armstrong's and many of his colleagues' opposition, Congress enacted legislation repudiating the government's promise to these developers that they could prepay their mortgages and opt out of the low-income housing program after 20 years. Legislators on both sides of the issue recognized that the legislation breached a contractual commitment made by the Department of Housing and Urban Development (HUD) to the developers. Until this litigation, HUD recognized this as well. In the decision below, however, the Federal Circuit agreed with HUD's litigation-born view that it made no such promise. In so concluding, the Federal Circuit eviscerated the rights of hundreds of developers who had joined with the government to build and maintain the nation's low-income housing.

1. This case involves agreements between the United States and private developers who built and operated federally-assisted, low-income housing projects under programs established by Section 221(d)(3) of the National Housing Act (NHA), Pub. L. No. 83-560, 68 Stat. 590, 599 (1954), *as amended by* Pub. L. No. 87-70, 75 Stat. 149 (1961), and Section 236 of the NHA, Pub. L. No. 90-448, § 201(a), 82 Stat. 476, 498-99 (1968). These federal programs were designed to, and did, encourage private parties to construct, own, and manage housing for low- and moderate-income families.[1] *See, e.g.*, H.R. Rep. No. 90-1585, at 2 (1968). They encouraged private development principally by providing mortgage insurance (which enabled the developers to obtain private loans) and affording developers the benefit of below-market interest rates (under Section 221(d)(3)) or direct interest subsidies (under Section 236). App., *infra*, 3a,

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[1] This brief generally will use the term "low-income" to refer to these classifications.

40a-41a. The developers were required to pass these financial benefits along to their tenants in the form of lower rent payments. *Id.* at 3a, 41a.

2. Petitioners are among the hundreds of private developers who accepted the government's invitation to participate in the Section 221(d)(3) and Section 236 programs. Their agreements were memorialized by the parties' execution of a series of detailed, interlocking contracts, all mandated, drafted, and approved by HUD. In each case, HUD issued a Commitment for Insurance of Advances, addressed to the Petitioner and the private lender for the project, which "set[] forth the terms and conditions upon which the mortgage [would] be insured." 24 C.F.R. § 221.509(a) (1970); App., *infra*, 14a. The Commitment was an offer by HUD, "under the provisions of [Section 221(d)(3) or Section 236, as applicable] of the National Housing Act, and the Regulations thereunder [then] in effect," to insure a deed of trust note between the Petitioner and the lender upon their satisfaction of specified conditions. Fed. Cir. J.A. 122, 142. "All certificates, documents, and agreements called for by [the] [C]ommitment [were required to] be on forms approved or prescribed by [HUD]." *Id.* at 124, 144. The Petitioner "agree[d] to accept a loan insured by [HUD] upon the terms set forth in [the] Commitment." *Id.* at 557, 559, 562. Among other things, the Commitment required the Petitioner to execute a regulatory agreement "to permit [HUD's] regulation of the [Petitioner] as to rents, charges, and methods of operation." App., *infra*, 15a (internal quotation marks omitted).

Each Petitioner entered into a regulatory agreement with HUD, as required by the Commitment and "[i]n consideration of the endorsement for

insurance by [HUD] of the [deed of trust] note."[2] *Id.* at 17a (first and third alterations in original). In the regulatory agreement, each Petitioner agreed to make all payments due under the note; to grant HUD a security interest in the income arising from the project; to rent to HUD-approved tenants at HUD-approved rent levels; to accept a six percent cap on its return on original equity; to submit to HUD audits, inspections, and management reviews; and to maintain the project according to HUD standards. Fed. Cir. J.A. 136-59. The Petitioner was bound by these obligations for so long as HUD insured the mortgage; once the mortgage was paid off (or prepaid), HUD's insurance obligation would terminate, and the Petitioner's obligations under its regulatory agreement would expire. App., *infra*, 4a-5a.

3. Although the mortgages had 40-year terms, Petitioners had the unfettered right to prepay after 20 years. This right was set forth expressly in Rider A to the note. The note was prepared on a standardized form drafted and prescribed by HUD. *Id.* at 4a; Fed. Cir. J.A. 132-35, 151-54. Rider A to the Section 221(d)(3) note provides that "a maker which is a limited distribution mortgagor may prepay without [HUD] approval after twenty (20) years from the date of final endorsement of this Deed of Trust Note."[3] Fed. Cir.

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[2] HUD signed the deed of trust notes twice as an endorser. 24 C.F.R. § 207.254 (1970). The first endorsement evidenced HUD's insurance of the mortgage. *Id.* § 207.254(a). The second endorsement, made after completion of construction, confirmed that the conditions for mortgage insurance had been fulfilled, and that all advances of mortgage proceeds had been made. *Id.* § 207.254(b).

[3] The right to prepay after 20 years without HUD approval was restricted to limited distribution mortgagors. Fed. Cir. J.A. 135, 154, 167, 170. Petitioners are limited distribution mortgagors. *Id.* at 94, 136, 155.

J.A. at 135. Rider A to the Section 236 note contained similar language. App., *infra*, 154, 167, 170. The prepayment right set forth in these riders was consistent with contemporaneous HUD regulations governing the Section 221(d)(3) and Section 236 programs. 24 C.F.R. §§ 221.524(a)(ii), 236.30(a)(i) (1970).

4. In reliance on their right to prepay and convert to conventional rentals at the end of the 20-year period, Petitioners developed properties which they believed would increase in value and allow them to attract market rate tenants. App., *infra*, 126a. They paid premiums for sites in middle class areas, constructed quality buildings and maintained the buildings with the same care as their conventional rentals. *Id.* at 126a-127a. The Court of Federal Claims specifically found that, when petitioners entered into their transactions with the government, they intended after 20 years to prepay their mortgages, terminate their participation in the assisted housing programs, and raise their rents to market levels. *Id.*

5. In the mid-1980s, Congress became "concerned that a large number of owners might shortly exercise their prepayment option" and thereby exit the Section 221(d)(3) and Section 236 programs. *Id.* at 5a. Fearing a shortage of affordable housing for low income tenants, Congress enacted the Emergency Low-Income Housing Preservation Act of 1987 (ELIHPA), Pub. L. No. 100-242, tit. II, 101 Stat. 1877 (1988). ELIHPA established a temporary moratorium on prepayment to provide Congress with "breathing room" to develop a permanent solution. App., *infra*, 43a. Under ELIHPA, a developer was permitted to prepay only if the termination of HUD restrictions would not cause hardship to current tenants or materially affect the

availability of low income housing. ELIHPA §§ 222, 225, 12 U.S.C. § 1715*l* note.

In 1990, Congress replaced ELIHPA's temporary measures with the Low-Income Housing Preservation And Resident Homeownership Act of 1990 (LIHPRHA), Pub. L. No. 101-625, tit. VI, 104 Stat. 4249 (1990), 12 U.S.C. § 4101 *et seq.* LIHPRHA made permanent the moratorium on unrestricted prepayment. App., *infra*, 5a. LIHPRHA also granted HUD the authority to grant "incentives" to encourage developers "to maintain affordability restrictions on their properties and not prepay their mortgage loans." *Id.* Nevertheless, LIHPRHA, like ELIHPA, prevented developers from "prepay[ing] their mortgage loans after twenty years without HUD approval, as had been permitted under the riders to deed of trust notes" and HUD regulations. *Id.* at 5a-6a.

6. As HUD expressly acknowledged at the time, the specific purpose of ELIHPA and LIHPRHA, was to repudiate the government's promise to allow developers to prepay their insured mortgages and exit the low-income housing program after 20 years. In 1986, R. Hunter Cushing, the Deputy Assistant Secretary for HUD's Multifamily Housing Programs, testified before Congress that, with respect to prepayment, "*there was a contractual relationship between the Federal Government and private owners, that was negotiated at that time, . . . an arm's length transaction that cannot be changed.*" *Loss of Subsidized Multi-family Housing Units: Hearing Before the Subcomm. on Housing and Community Development of the House Comm. on Banking, Finance and Urban Affairs*, 99th Cong. 17 (1986) (*Loss of Subsidized Housing Units*) (emphasis added). Senator D'Amato, who introduced ELIHPA, acknowledged that "[o]wners of projects, who have lived up to a 20-year

agreement with the Federal Government, may be forced [by the moratorium on prepayment] to renegotiate their contracts with the Government." 133 Cong. Rec. 22,209 (1987). Congress determined, however, that the immediate threat to low-income housing justified compromising the prepayment rights of the private developers. *See, e.g.*, H.R. Rep. No. 100-122(I), at 37 (1987) ("The Committee wishes to state that in developing these provisions every attempt was made to balance the contract rights of owners with the need to try to preserve the existing stock of housing for low income persons.").

In 1990, when Congress considered LIHPRHA, HUD Secretary Jack Kemp testified that the existing moratorium on prepayment was a trespass on the rights of low-income housing developers and emphasized the government's duty to fulfill the "commitment to the contract that we entered into with people." *HUD Legislative Proposals: Hearing Before the Subcomm. on Housing and Community Development of the House Comm. on Banking, Finance and Urban Affairs*, 101st Cong. 41 (1990). The Members of the House Committee that proposed LIHPRHA similarly understood that the legislation would breach contracts that the federal government had executed with low-income housing developers. *See Preservation and the Loss of Subsidized Housing Stock: Hearing Before the Subcomm. on Housing and Community Development of the House Comm. on Banking, Finance and Urban Affairs*, 101st Cong. 23-24 (1990); *id.* at 6 ("Just because [of] some fine print allowing prepayment, we're not to cave in and abandon that commitment to tenants.") (statement of Rep. Kennedy); *see also* 136 Cong. Rec. 21,244 (1990) ("In many of the contractual agreements with the government, developers were promised the opportunity to prepay these 40-year mortgages after 20 years.") (statement of Rep. Hoagland).

Extension of the moratorium generated extended and heated debate, with many Members of Congress opposing the legislation on grounds that the United States should honor its contractual commitments. Senator Heflin, among others, addressed the point directly:

> Mr. President, I rise today to address an issue which I feel is of the utmost importance: that is the obligation of the U.S. Government to fulfill contractual agreements into which it enters, or, at a minimum, to justly compensate those parties whose contractual rights it abrogates.
>
> In 1961, Congress enacted the 221(d)(3) program to encourage private development of low- and moderate-income housing under which the Government offered project owners federally insured, 40-year loans at the Federal borrowing rate. In exchange, the Government required that project owners pass the interest benefits to the tenants through lower rents. The owners undertook the risk of building and operating the housing in addition to accepting the limitations of the use of their property and distribution of earnings. This was balanced by the unrestricted right to prepay these mortgages and use the property freely after 20 years.
>
> In 1987, in order to address the possibility that owners would prepay and remove their projects from the low-income inventory, Congress placed a 2-year moratorium on the right to prepay at a time when neither States nor the Federal Government were able to dedicate funds to new construction of low-income housing. That moratorium was extended and expires on September 30 of this year.

> Mr. President, the very notion of unilaterally abrogating a contract, which has been adhered to by one party for 20 years, flies in the face of the law. I am opposed to it, except in the most extreme circumstances. And when such circumstances arise, that party whose rights are denied must be fully compensated.

136 Cong. Rec. 26,372 (1990). His sentiments were echoed by several colleagues. *See, e.g., id.* ("Unilateral abrogation of 20-year-old contracts is not the way to build confidence. Nor is unequitable reimbursement the answer.") (statement of Senator Breaux); *id.* ("[T]he providers of housing honored the contract for 20 years. For 20 years, they stood by the conditions of the contract. Now, the Government is coming back -- the Government for heaven's sake; it would be bad enough if it were private parties -- but the Government is coming back saying, 'Well, we changed our mind. We are going to welsh on the deal.'") (statement of Senator Armstrong); *id.* at 26,375 ("I want to see us protect those contractual rights that the owners entered into some 20 years ago.") (statement of Senator Mack).

Even the proponents of an extended moratorium on prepayment acknowledged that it would compromise the government's contracts with the housing developers. Senator Cranston defended the legislation by asserting that Congress's authority to "adjust the burdens and benefits of economic life" included the ability to "specifically alter the instrument of the parties who contracted with the Federal Government." *Id.* at 26,371; *see also id.* at 26,374 ("[M]any believe that the Senate prepayment provision contained in the housing bill may lean so far in the direction of tenant protection that, ultimately, the Federal Government is not honoring its contractual agreement with owners. This is the issue that Senator Armstrong is raising.

And, in all candor, I think we have to agree with him.") (statement of Senator D'Amato); *id.* at 26,385 ("I do not think we have a right to arbitrarily say contracts that were entered into in good faith years ago, which drew people into an arrangement which allowed them to put their private capital on the table and suggested to them sometime as a consequence of that they would be able to make a profit – all of a sudden we would be willing to say sorry, we are changing the rules.") (statement of Senator Kerry).

Ultimately, Congress determined (as it had in 1988) that the threat of losing low-income housing justified the new legislation. Pub. L. No. 101-625, 104 Stat. 4249 (1990); *see also* H.R. Conf. Rep. 101-625, at 458 (1990).

7. Petitioners and 42 other low-income housing development partnerships brought this action under the Tucker Act, 28 U.S.C. § 1491, to recover damages they suffered from their inability to prepay their mortgages and convert their properties to market rentals.[4] App., *infra*, 2a & n.1. They alleged that, by enacting ELIHPA and LIHPRHA, the government breached its contractual promise that they would have the unfettered right to prepay their mortgages after 20 years. In orders dated March 27, 1995 (*id.* at 39a-91a) and December 11, 1996 (*id.* at 92a-103a), the Court of Federal Claims granted Petitioners' motions for summary judgment on their breach of contract claim.

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[4] Sherman Park Apartments and St. Andrews Gardens eventually obtained subsidies under ELIHPA that approximate market-level rents. Independence Park Apartments and Pico Plaza Apartments sought low-income preservation incentives under LIHPRHA, but in lieu of funding these incentives, Congress passed the Housing Opportunity Program Extension Act of 1996, Pub. L. No. 104-120, 110 Stat. 834 (HOPE Act). The HOPE Act permitted developers to prepay their mortgages so long as they agreed not to raise rents for 60 days. Fed. Cir. J.A. 49.

In granting summary judgment for Petitioners, the Court of Federal Claims rejected the government's argument that, because the prepayment provisions "were contained in the deed of trust notes entered into by [Petitioners] and their lenders, [and] not in the regulatory agreement into which HUD entered with the owners," Petitioners' "putative prepayment rights are not enforceable against the government." *Id.* at 59a. Observing that "essential terms of the regulatory agreement make explicit reference to terms of the deed of trust note," that "the regulatory agreement, by its terms, was to remain in effect as long as the deed of trust note remained outstanding," and that "the rider specifically allocated certain rights between HUD and [Petitioners]," the court held that the government need not be a "named party" to the note for it to be bound by its prepayment promise. *Id.* at 56a-57a.

In determining the extent of the government's prepayment obligations, the Court of Federal Claims adhered to the common law rule that "all writings that are part of the same transaction are interpreted together." *Id.* at 58a (quoting *Restatement (Second) of Contracts* § 202 (1981)). Applying this rule, the court held that the regulatory agreement and the deed of trust note -- which were executed contemporaneously -- "must be read together in order to determine the full intentions of the parties when they initially entered into their relationship." *Id.* By viewing the transaction as a whole, the court found that "when the parties in this case entered into the regulatory agreement, they also intended to be mutually bound by the prepayment rules set forth in the rider to the contemporaneous deed of trust note." *Id.*

Having found the government in privity, the court concluded that the undisputed facts established the government's breach, *id.* at 58a-59a, 99a, and, after a

four-day trial, the court awarded the Petitioners $3,061,107 in damages. *Id.* at 11a, 104a-159a.[5]

8. A divided panel of the Federal Circuit reversed. The panel majority refused to construe the interlocking, contemporaneously-executed documents together to determine the intent of the parties. Instead, the majority stated that "all of the agreements . . . are relevant" only in "determining the meaning of each separate contract." *Id.* at 21a-22a. Thus, although the deed of trust note addresses prepayment, the majority held that "the agreement represented by each deed of trust note was between the relevant [Petitioner] and its private lending institution" only, and that HUD was not a party to either the note or its rider. *Id.* at 20a. Because it found that HUD "was a named party to only . . . the regulatory agreement," which did not "mention prepayment" and "did not incorporate any other agreement, including the deed of trust note or Rider A to the deed of trust note," *id.* at 19a, the majority held that HUD never made any promise concerning prepayment at all. *Id.* at 22a.

In reaching that conclusion, the panel majority gave no weight to the Commitment's incorporation of contemporaneous HUD regulations, which expressly permitted prepayment after 20 years. *Id.* at 22a-24a. To the contrary, the majority held that, because HUD reserved the power to amend its regulations, "it would have been inconsistent for HUD to have entered into the regulatory agreement if the agreement fixed" Petitioners' prepayment rights. *Id.* at 24a.

In the panel majority's view, the courts' holdings in *Winstar Corp. v. United States*, 64 F.3d 1531 (Fed. Cir. 1995) (*in banc*), *aff'd*, 518 U.S. 839 (1996), had no

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[5] Petitioners, four of the 42 plaintiffs in this action, were selected as "model plaintiffs" for purposes of the damages trial. *Id.* at 2a n.1, 11a.

application to this case. App., *infra*, 27a-29a. Although *Winstar* also involved a complex government transaction involving multiple, interlocking documents, the majority held that *Winstar* was distinguishable because the agreements in *Winstar* had an integration clause that incorporated the contemporaneous documents which formed the basis of plaintiffs' claims. *Id.* at 28a.

Judge Archer, author of the Federal Circuit's *in banc* decision in *Winstar*, dissented. He faulted the majority for considering each of the documents involved in the transaction "in virtual isolation" (*id.* at 35a) and failing to examine several "critical factors" to determine the parties' intent. *Id.* at 31a. In contrast to the majority, Judge Archer considered the *quid pro quo* that arose between the government and the private developers to accomplish the goal of constructing and operating low-income housing. *Id.* at 31a. Specifically, Judge Archer observed that the developers agreed to accept certain "disincentives," *i.e.*, restrictions on rent and the income they could earn, in exchange for the promise that they could convert their projects to market properties without HUD approval after 20 years. *Id.* Judge Archer also examined the "nature and mechanics of the transactions," including the fact that HUD "furnished" the prepayment language in the rider to the deed of trust notes. *Id.* at 32a. Based on his evaluation of these factors, Judge Archer thought it "entirely appropriate" for the Court of Federal Claims "to find the parties' intent based on all of the documents and the surrounding facts and circumstances . . . in complex, integrated transactions of this sort, where multiple parties executed multiple documents at closing." *Id.* at 35a.

Judge Archer also looked to the Commitment for Insurance of Advances in determining the parties'

intent. Although the Commitment was largely ignored by the majority, Judge Archer (quoting in part from the Commitment) explained that it constituted HUD's offer "under the . . . provisions [of Section 221(d)(3) or Section 236, as applicable] of the National Housing Act, and 'the Regulations thereunder *now in effect*,'" to provide mortgage insurance upon the satisfaction of certain conditions, including the plaintiffs' execution of the deed of trust note. *Id.* at 37a. Noting that the HUD regulations *then in effect* afforded property owners the right to prepay their mortgages after 20 years, *id.*, Judge Archer concluded that, by endorsing the deed of trust note for insurance, the government bound itself to permit prepayment without HUD approval after 20 years. *Id.*

REASONS FOR GRANTING THE PETITION

Over 20 years ago, the government intentionally induced hundreds of private developers across the nation to invest billions of dollars to construct and operate low-income housing with the promise that, after 20 years, they would have the unfettered right to convert their properties to market rentals. Because the agreements that each of these developers executed with the government are substantially similar, *see, e.g.*, *Lurline Gardens v. United States*, 37 Fed. Cl. 415 (1997); *Greenbrier v. United States*, 40 Fed. Cl. 689 (1998), the Federal Circuit's decision in this case will affect the 600 private developers who have brought 21 separate actions for hundreds of millions of dollars in damages they suffered as a result of the government's breach of its prepayment promise.[6] The Federal Circuit concluded, as a matter of law, that the promise was never made because it improperly considered each of

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[6] *See* Brief of Defendant-Appellant United States, filed with the Federal Circuit on Oct. 20, 1997, at 3 n.3 (summarizing pending actions before the Court of Federal Claims).

the interrelated documents in isolation, and refused to look to the realities of these transactions.

Judge Archer in dissent correctly observed that, particularly "in complex integrated transactions . . . where multiple parties execute[] multiple documents at closing," the intent of the parties must be determined by considering all of "the documents and the surrounding facts and circumstances." App., *infra*, 35a. Judge Archer's approach was followed by Judge Robinson, the trial court judge in this case, and has been adopted by two other judges on the Court of Federal Claims. *See id.* at 56a-59a; *Statesman Sav. Holding Corp. v. United States*, 41 Fed. Cl. 1, 6-8 (1998) (Miller, J.); *California Fed. Bank v. United States*, 39 Fed. Cl. 753, 772-74 (1997) (Smith, J.). The panel majority, however, finding no explicit incorporation clause, rejected Judge Archer's approach, and instead viewed each of the constituent documents in this case as a "separate agreement[]."[7] App., *infra*, 22a. As a result, the Court failed to give effect to the parties' undisputed intentions, and permitted the government to repudiate a promise with which it had induced private developers to invest billions of dollars in low-income public housing.

This case raises fundamental issues of law that affect all who enter into complex transactions with the government. Because the Court of Federal Claims has exclusive jurisdiction under the Tucker Act over significant claims for money damages arising from government contracts, 28 U.S.C. § 1491, the impact of this decision is enormous. For example, in addition to the actions brought by 600 developers with regard to

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[7] The reasoning of the panel majority has been followed in *Lurline Gardens*, 37 Fed. Cl. at 420-21 (Weinstein, J.) and *Greenbrier*, 40 Fed. Cl. at 698-700 (Merow, J.).

these contracts, over 120 cases are pending before the Court of Federal Claims as a result of this Court's decision in *United States v. Winstar Corp.*, 518 U.S. 839 (1996), which held that savings and loans associations that relied on the government's promise of favorable regulatory treatment could recover damages for breach of contract after the government reneged on its promise. *See California Fed. Bank*, 39 Fed. Cl. at 755. The Federal Circuit's decision in this case casts doubt on the ability of many of these *Winstar*-related plaintiffs to recover, because in many cases the promise of favorable regulatory treatment was not expressly incorporated into a written agreement to which the savings and loan and the government were signatories. *See id.* at 772-73.

The Federal Circuit's approach to these complex, multiparty government agreements is contrary to core, longstanding principles of law and flatly inconsistent with this Court's guidance in *Winstar*. If it is not reversed, this decision will not only result in manifest injustice to hundreds of private developers, but will gravely affect the government's ability in the future to enlist the private sector in partnership for its public programs. The Court should grant this petition for certiorari because of the importance of the questions raised to the administration of government contracts and to the legitimate expectations of thousands of private parties who contract with the government.

1. No one ever disputed in this case that the government provided Petitioners the option of early prepayment in order to entice them to participate in HUD's low-income housing program. The language governing prepayment in Rider A to the deed of trust note was required and "supplied by HUD" (*see* App., *infra*, 56a-57a & n.9) and effectively tracked the rule established in contemporaneous HUD regulations. *See*

24 C.F.R. §§ 221.524(a)(ii); 236.30(a)(i) (1970). HUD has admitted frankly that it provided the developers a 20-year contractual prepayment right "to get [developers] involved in the program, . . . to try and convince them to get in the program."[8] Jona Goldrich, the founder and general partner of each of the Petitioners, provided uncontradicted testimony that he paid premiums for sites in middle class neighborhoods and maintained the buildings with the same care as his conventional rentals in reliance on the government's promise that he could prepay the mortgages and convert the properties to conventional rentals after 20 years. *See* Fed. Cir. J.A. 482-83.

Further, before the commencement of litigation arising out of the enactment of ELIHPA and LIHPRHA, no one disputed that the government's prepayment promise was a *contractual* commitment between the government and the developer. Indeed, even in litigation, HUD initially represented in federal court that it "did enter into contracts" with developers with respect to the prepayment promise.[9] Moreover, as recently as February 1997, HUD argued that the proper way to interpret the interlocking documents involved in this case is to construe the "regulatory agreement . . . in the context of its role in effectuating a program under the National Housing Act and with regard to the documents that together comprise the loan transaction, specifically the mortgage instruments."[10]

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[8] *Loss of Subsidized Multifamily Housing Units* at 18 (1986).

[9] *See* Brief for the Appellees, filed on Jan. 8, 1990 in *Thetford Properties IV Ltd. Partnership v. United States*, No. 89-1778 (4th Cir.), at 24.

[10] United States' Memorandum in Opposition to the Defendants' Motion for Summary Judgment, filed on Feb. 24, 1997 in *United States v. David*, No. 94-7191 (E.D. Pa.), at 4.

Contrary to the majority's reasoning, the various constituent documents in each transaction did not "stand[] alone." App., *infra*, 22a. The panel majority failed to appreciate that the regulatory agreement executed by HUD was to remain in force only while the mortgage loan remained outstanding, and the duration of the mortgage loan could in turn be determined only by considering the prepayment provision in Rider A to the deed of trust note. By prohibiting prepayment of the mortgage loan without HUD approval during the first 20 years, the rider provided HUD the right to enforce the regulatory agreement for at least that long. Correspondingly, by permitting the developer to prepay without HUD approval after 20 years, the rider granted the developer the unfettered right to terminate the regulatory agreement at that time. Despite universal acknowledgment of the importance of Petitioners' prepayment rights in the overall scheme of the transaction, the panel majority, by addressing each component of the transaction separately, concluded those rights were not enforceable against HUD.

By construing the deed of trust note and its rider as an agreement only "between the relevant [Petitioner] and its private lending institution," *id.* at 20a, the panel majority ignored the entire context of the instrument: HUD required the prepayment provision in the rider to the deed of trust note *for its own benefit*, to ensure that it had the right under the regulatory agreement to require Petitioners to remain in the low-income housing program for at least 20 years and to induce Petitioners - with an assurance respecting prepayment – to enter into the regulatory agreements in the first place. The panel's decision effectively treats HUD as a stranger to the note and its rider, even though the language was drafted by HUD, the sole purpose of the rider was to allocate rights and obligations between the plaintiffs and HUD, and HUD's approval of the note

and its rider was a specific condition to HUD's offer as expressed in the Commitment.

2. The Federal Circuit's refusal to consider the entire transaction framed by the interrelated documents is flatly inconsistent with the approach taken by this Court in *Winstar*. Like this case, *Winstar* involved a circumstance in which the federal government required the assistance of private parties to accomplish an important public endeavor; in that case, the rescue of the failing savings and loan industry. 518 U.S. at 844-48. Lacking the funds to resolve the savings and loan crisis directly, the government enticed healthy savings and loans to acquire failing thrifts with the promise of favorable regulatory treatment. *Id.* at 847-48. This favorable treatment included allowing the healthy thrift to count goodwill from the acquisition as capital for purposes of federal solvency regulations, allowing the thrifts to amortize the goodwill over a 40-year period, and allowing the thrift to count cash received from the government both as an intangible and as a tangible asset. *Id.* at 850-53.

When this policy failed to resolve the savings and loan crises, Congress enacted a new statute that drastically altered federal regulation of the savings and loan industry, including eliminating the favorable regulatory treatment that the federal government had promised to allow. *Id.* at 856-58. In the resulting litigation, the government argued, as it argued here, that its promise of favorable regulatory treatment "simply reflect[ed] statements of then-current federal regulatory policy rather than contractual undertakings." *Id.* at 862 (plurality opinion). This Court rejected that argument, finding "unconvincing" the government's suggestion "that the parties meant to say only that the regulatory treatment laid out in these documents would apply as an initial matter, subject to

later change at the Government's election." *Id.* at 909-10 (plurality opinion); *see also id.* at 919 (Scalia, J., concurring in the judgment) ("I agree with the principal opinion that the contracts at issue in this case gave rise to an obligation on the part of the Government to afford respondents favorable accounting treatment.").

Although *Winstar* and this case both involve incentives offered by the government to induce private parties to participate in government transactions memorialized by a series of contemporaneous, interlocking writings, the Federal Circuit refused to apply *Winstar* to this case. App., *infra*, 27a-29a. The panel majority sought to distinguish *Winstar* because of the presence in that case of "integration clauses that expressly incorporated contemporaneous documents that allowed" the thrifts to receive favorable regulatory treatment. *Id.* at 28a. Although the deed of trust note and its rider containing the prepayment provision are "contemporaneous documents," the majority held that they could not bind the government because they were not "expressly incorporated" into a document to which Petitioners and HUD were formal parties. *Id.*

The panel majority fundamentally misread *Winstar*. The Supervisory Assistance Agreements (SAAs) that were at issue in *Winstar* did *not* expressly incorporate the promise of favorable regulatory treatment. Rather, each SAA contained an integration clause which prohibited consideration of other documents except for Bank Board resolutions referencing the regulatory forebearances. The Bank Board resolutions stood in the same position *vis-à-vis* the SAAs as the deed of trust notes in this case stand *vis-à-vis* the regulatory agreement, which contains no integration clause.

Contrary to the panel majority's view, moreover, while an express incorporation provision "often makes clear precisely what documents constitute a contract,"

it is not a precondition to an integrated consideration of contemporaneously-executed documents. *California Fed. Bank*, 39 Fed. Cl. at 773; *see also id.* at 774. ("Mutuality of intent, even in the context of written contracts, may be established by several contractual instruments as opposed to one superseding document .... Contracts are frequently found to exist despite the absence of an integrating document."). Until this decision, even the government rejected the notion that "the presence of an explicit, integrated contract is the *sine qua non* of governmental contractual liability."[11] In fact, while this case was pending before the Federal Circuit, HUD argued in a separate proceeding involving similar documents that "the mortgage..., the note [and] the Regulatory Agreement" must be construed together as the "entire contract between the parties." *United States v. David*, No. 94-7191, 1998 WL 351693, at *4 (E.D. Pa. June 30, 1998). Not surprisingly, the day after the panel's opinion was issued, the government altered its stance 180°: it now contends that the presence *vel non* of an integration clause is "critical" in determining the extent of the government's contractual promises. *See* Defendant's Response to the "Select Committee's Amicus Curiae" Brief Concerning "The Absence Of Any Relationship" of the Standing Argument to the Source of Payment for Judgments in the Winstar-Related Cases, filed on Dec. 8, 1998 in *Plaintiffs in All Winstar-Related Cases at the Court v. United States*, Nos. 90-8C *et al.* (Fed. Cl.), at 5-7 (*Winstar Brief*).

Further, although the SAAs' integration clauses were relevant in *Winstar*, the *Winstar* plurality indicated that, even absent such clauses, reference to

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[11] *See* Defendant's Request for Certification of an Interlocutory Appeal, filed on June 17, 1990 in *Suess v. United States*, No. 90-981C (Fed. Cl.), at 6.

the overall facts and circumstances of the transaction would have led to the same result. *Winstar*, 518 U.S. at 863 ("To the extent that the integration clause leaves any ambiguity, . . . the realities of the transaction favored reading those documents as contractual commitments.") (plurality opinion). In this case, by declining to consider the overall facts and circumstances and the "realities of the transaction," the Federal Circuit failed to give effect to the parties' intent. *See The Binghamton Bridge Co.*, 70 U.S. (3 Wall.) 51, 76 (1865) ("[I]t should never be lost sight of, that the main canon of interpretation of a contract, is to ascertain what the parties themselves meant and understood.").

Had the panel majority adhered to reasoning of *Winstar*, it would have found that the documents here, as in *Winstar*, evidence the parties intent to bind the government contractually; and to the extent the documents leave "any ambiguity," the "realities of the transaction" would have resolved those ambiguities in Petitioners' favor. 518 U.S. at 863 (plurality opinion). The realities are that the undisputed purpose of "the 20-year lock-in period" was "to get [for-profit developers] involved in the program, . . . to try and convince them to get in the program." *Loss of Subsidized Multifamily Housing Units* at 18. And, indeed, the Court of Federal Claims expressly found that Petitioners got "involved in the program" (*id.* at 18) in reliance on the government's prepayment incentive (App., *infra*, 126a-127a), a finding that the Federal Circuit did not reverse.

As noted above, Congress knew full well that the "specific object" of ELIHPA and LIHPRHA was to "abrogat[e]" the government's contractual promise to allow developers to prepay their insured mortgages after 20 years and exit the HUD program. *See Winstar*,

518 U.S. at 900 (plurality opinion); *see also id.* at 924 (Scalia, J., concurring in the judgment) (observing that "Congress specifically set out to abrogate the essential bargain of the contracts at issue"). Congress enacted ELIHPA and LIHPRHA not because it determined that the government had not made a prepayment promise, but because it concluded that the interests of low-income tenants outweighed the government's contractual commitments. *See, e.g.*, H.R. Rep. No. 101-122(I), at 37 (1987); H.R. Conf. Rep. 101-625, at 458 (1990).

The Federal Circuit improperly ignored the relationship among the documents and other abundant evidence of the parties' undisputed intent, however, and instead applied a "narrow and technical" construction that "defeat[ed] the very end" the parties sought to accomplish. *The Binghamton Bridge Co.*, 70 U.S. (3 Wall.) at 78 (refusing to apply the literal language that was incorporated into a contract, where doing so would "defeat the very end the legislature had in view" when it entered into the contract).

In contrast to the Federal Circuit's decision in this case, the Ninth Circuit articulated the correct approach in *Far West Fed. Bank, S.B. v. Office of Thrift Supervision-Director*, 119 F.3d 1358 (9th Cir. 1997). In that case, the Ninth Circuit concluded that investors in a failed thrift who did not sign a contract with the government in their individual capacities could nevertheless pursue a *Winstar*-type suit against the government. Noting that the "sole purpose of the entire transaction [at issue] . . . was for the Investors to invest $26.6 million in Far West in exchange for promises by the [government] to regulate Far West in a manner that would make their investments financially sound," the Ninth Circuit held that "[t]o deny the Investors an opportunity to recover for [the

government's] breach simply because Far West and not the Investors signed one of the documents evidencing those promises would place the form of the agreement over its substance." *Id.* at 1364; *see also Bluebonnet Sav. Bank, F.S.B. v. United States*, 43 Fed. Cl. 69, 74 (1999) (holding that plaintiffs who were not signatories to a contract were nevertheless parties to it). The Federal Circuit's failure to hold the government to the promise it made regarding prepayment similarly placed form over substance, and in doing so, failed to give due regard to the intentions of the parties to these transactions.

3. The Federal Circuit also misapplied fundamental principles that guided this Court's decision in *Winstar* by deeming insignificant the Commitment's incorporation of regulations that were in effect at the time of the transaction, which provided the developers a 20-year prepayment right. By incorporating the regulations *then in effect* into its offer to the developers, HUD did not merely promise to apply its regulations as they might change from time to time, but instead relinquished its right to change the terms of the contract by amending those regulations.

The Federal Circuit declined to consider this evidence of HUD's intent because, according to the court, "it would have been inconsistent" for HUD to make a promise to allow prepayment "in view of the express power to amend" the "regulations at any time that was reserved to HUD." App., *infra*, 24a. There would, however, have been nothing inconsistent in HUD binding itself contractually to specific parties to abide by the regulations then in effect while retaining the right generally to amend the regulations at any time. *Cf. Winstar*, 64 F.3d at 1542 ("While it is true as the government argues that a statement of policy . . . could be changed (which it later was), the

contract could not be changed except by mutual consent").

The panel majority's reasoning is utterly contrary to the long-established rule that a general reservation of a power to amend does not signify the right of the government to renegotiate the essential terms of a contract. *See, e.g., City of Detroit v. Detroit Citizens' Street Ry. Co.*, 184 U.S. 368, 383-85 (1902) (holding that a city's reservation of right to prescribe regulations "from time to time" did not include the authority to reduce the rates that a streetcar company could charge, where the fixing of rates was "among the most material and important of the terms and conditions" of the contract); *see also id.* at 396-98. Indeed, the majority's view – that the Commitment's incorporation of the regulations then in effect included the regulation permitting their amendment – is "an absolutely classic description of an illusory promise." *Winstar*, 518 U.S. at 921 (Scalia, J., concurring in the judgment).

4. Unless reversed, the Federal Circuit's decision in this case will result in an unjustified windfall to the government, which received everything for which it bargained when it entered into the Section 221(d)(3) and Section 236 transactions, and a grave injustice to hundreds of private developers, who volunteered to join with the government to provide low-income housing for 20 years, and, by virtue of the enactment of ELIHPA and LIHPRHA, were forced to subsidize the low-income housing program beyond that agreed-upon term. The forced rental subsidies claimed by these private developers amount to hundreds of millions of dollars.

The Federal Circuit's opinion will also affect a great number of the savings and loans who relied on the same promise and suffered the same type of damages as the *Winstar* thrifts, but will be unable to recover because

"there is no single, integrating" agreement between the thrifts and the government. *California Fed. Bank*, 39 Fed. Cl. at 773-74 (rejecting, prior to the Federal Circuit's decision in this case, the government's argument that an express integration is required to recover for breach of contract). The government cannot deny the effect of the Federal Circuit's decision in this case on those savings and loans, having cited the decision immediately as precedent in several pending *Winstar* suits.[12]

Unless this decision is reversed, it will further encourage the government to renege on its promises to private parties once they have fulfilled their end of the bargain. When the government attempted to achieve the same result in *Winstar*, this Court rejected the government's attempt to hide behind technical arguments, and looked to the "realities of the transaction" to determine the parties' true intentions. *Winstar*, 518 U.S. at 863 (plurality opinion). It should do so here as well.

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12 See *Winstar Brief* at 6 (citing the Federal Circuit's opinion to support the argument that the presence of an integration clause is a "critical and recognized distinction" between the Winstar plaintiffs that may recover for breach of contract and those that may not).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A

UNITED STATES COURT OF APPEALS
FEDERAL CIRCUIT

Nos. 97-5126, 97-5134.

CIENEGA GARDENS, ET AL., PLAINTIFFS-CROSS-APPELLANTS,

v.

UNITED STATES, DEFENDANT-APPELLANT.

[Argued May 6, 1998]
[Decided Dec. 7, 1998]

OPINION

Before: MAYER, Chief Judge, ARCHER, Senior Circuit Judge, and SCHALL, Circuit Judge.

Opinion for the Court filed by Circuit Judge SCHALL. Dissenting opinion filed by Senior Circuit Judge ARCHER.

SCHALL, Circuit Judge.

The United States appeals from the judgment of the United States Court of Federal Claims in a case arising out of contracts for the construction, financing, and regulation of low-income housing. *Cienega Gardens v. United States*, No. 94-1 C (Fed. Cl. June 18, 1997). The court ruled, on summary judgment, that the enactment

of the Emergency Low Income Housing Preservation Act of 1987, Pub.L. No. 100-242, 101 Stat. 1877 (1987) (pertinent parts *reprinted* in 12 U.S.C. § 1715*l* note (1989) (Preservation of Low Income Housing)) (hereinafter "ELIHPA") and the enactment of the Low-Income Housing Preservation and Resident Homeownership Act of 1990, Pub.L. No. 101-625, 104 Stat. 4249 (1990) (codified at 12 U.S.C. § 4101 *et seq.*) (hereinafter "LIHPRHA") breached contracts between the plaintiffs, owners of low-income housing, and the Department of Housing and Urban Development ("HUD"). *See Cienega Gardens v. United States*, 33 Fed. Cl. 196, 202, 210 (1995); *Cienega Gardens v. United States*, 37 Fed. Cl. 79, 80, 84 (1996). Following a trial on damages, the court awarded damages in the total amount of $3,061,107 to plaintiffs/cross-appellants, Sherman Park Apartments, Independence Park Apartments, Pico Plaza Apartments, and St. Andrews Gardens. *See Cienega Gardens v. United States*, 38 Fed. Cl. 64, 66 (1997).[1] Because we conclude that the requisite privity of contract did not exist between the Owners and HUD with respect to prepayment of the

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[1] The Court of Federal Claims, on summary judgment, found the government liable for breach of contract with respect to all of the plaintiffs listed in the caption (referred to collectively as "Owners"). *See Cienega Gardens v. United States*, 33 Fed. Cl. 196, 210 (1995); *Cienega Gardens v. United States*, 37 Fed. Cl. 79, 84 (1996). For purposes of judicial economy and to conserve the parties' resources, however, the Owners and the government selected four "model plaintiffs" for purposes of litigating the damages issue. *See Cienega Gardens*, 38 Fed. Cl. at 67 n. 3. After the damages trial, the court entered judgment with respect to the four model plaintiffs, Sherman Park Apartments, Independence Park Apartments, Pico Plaza Apartments, and St. Andrews Gardens. *See Cienega Gardens v. United States*, No. 94-1 C (Fed. Cl. June 18, 1997). The court stayed all proceedings with respect to the remaining thirty-eight Owners listed as plaintiffs in the caption of this appeal. *See Cienega Gardens v. United States*, 94-1 C (Fed.Cl. May 15, 1997).

mortgage loans, so as to make HUD liable to the owners for breach of contract, we vacate and remand, with the instruction that the breach of contract claims be dismissed.

BACKGROUND

I.

In the 1950s and 1960s, in an attempt to encourage private developers to construct, own, and manage low and moderate-income housing, Congress enacted legislation that allowed the Federal Housing Administration, and later HUD,[2] to provide mortgage insurance. This insurance enabled private lending institutions to provide low-interest mortgages to project developers. *See Cienega Gardens*, 33 Fed. Cl. at 202. Under two programs instituted under the National Housing Act of 1934, along with the mortgage insurance, developers also received certain financial incentives. *See id.*

Prior to 1968, owners/developers received below-market mortgage interest rates through a program referred to as "Section 221(d)(3)," 12 U.S.C. § 1715*l*(d)(3). *See Cienega Gardens*, 33 Fed. Cl. at 202 (citing Pub.L. No. 83-560, 68 Stat. 590, 597 (1954), *amended by*, Pub.L. No. 87-70, 75 Stat. 149 (1961)). Owners obtaining mortgages after 1968 received market-rate mortgages with an interest subsidy through a program referred to as "Section 236," 12 U.S.C. § 1715z-1. *See Cienega Gardens*, 33 Fed. Cl. at 202 (citing Pub.L. No. 90-448, § 201(a), 82 Stat. 476, 498, 499 (1968)). Owners were expected to pass the benefits of the program in which they participated on to their tenants in the form of lower rents. *See id.* at 202-03.

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[2] In 1965, the Federal Housing Administration was subsumed into the then newly-established Department of Housing and Urban Development. *See* 24 C.F.R. §§ 200.1, 200.2 (1994).

Generally, when obtaining a HUD-insured mortgage under either of the above programs, an owner executed a deed of trust note payable to a private lending institution. *See id.* at 203. The note evidenced a loan made to the owner pursuant to a loan agreement between the owner and the lending institution that contemplated advances to the owner. Payment of the indebtedness evidenced by the note was secured by a deed of trust, or a mortgage, on the subject property. The note and deed of trust were printed on forms approved by HUD, and HUD endorsed the note as part of its mortgage insurance. *See id.* The repayment term of the loan was generally forty years. *See id.* Simultaneously, in exchange for HUD's endorsement for insurance (pursuant to a commitment for insurance), the owner entered into a "regulatory agreement" with HUD, under which the owner agreed, among other things, to certain "affordability restrictions," including restrictions on the income levels of tenants, restrictions on allowable rental rates, and restrictions on the rate of return the owner could receive from the housing project. *See id.* The regulatory agreement and the mortgage insurance provided by HUD were to remain in effect so long as the loan remained outstanding. *See id.*

While the regulatory agreement made no mention of the right to prepay the outstanding loan, a rider to the deed of trust note permitted the owner to prepay the loan in full, without HUD approval, after twenty years. *See id.* Developers could not prepay their loans prior to twenty years, except under certain conditions, including HUD approval. *See id.* The prepayment rules in the riders reflected contemporaneous HUD regulations, *see* 24 C.F.R. §§ 221.524(a)(ii), 236.30(a)(i) (1970), governing the Section 221(d)(3) and Section 236 programs. *See Cienega Gardens*, 33 Fed. Cl. at 203. By prepaying the outstanding loan, an owner could

terminate HUD's affordability restrictions on the property. The owner then could convert the property into a conventional rental property and charge market rental rates, thereby obtaining a greater return on the investment.

II.

In the late 1980s, concerned that a large number of owners might shortly exercise their prepayment options, thereby reducing the supply of low-income rental housing, Congress enacted ELIHPA. *See id.* ELIHPA took effect on February 5, 1988. *See* 12 U.S.C. § 1715*l* note (1989) (Preservation of Low Income Housing, § 234). It placed a two-year moratorium on mortgage prepayments to allow Congress time to devise a permanent solution to the possible shortage of low-income housing, *see* 12 U.S.C. § 1715*l* note (1994) (Preservation of Low Income Housing, § 221(b)). *See Cienega Gardens*, 33 Fed. Cl. at 203-04. ELIHPA did not prohibit prepayments altogether, however. Rather, it required HUD approval prior to prepayment, even after twenty years. *See* 12 U.S.C. § 1715*l* note (1994) (Preservation of Low Income Housing, §§ 221(a), 222, 225); *Cienega Gardens*, 33 Fed. Cl. at 204.

In 1990, ELIHPA was replaced by LIHPRHA, which took effect on November 28, 1990. *See* 12 U.S.C. § 4101 note (1994) (Historical and Statutory Notes: Effective Dates). LIHPRHA made the moratorium on prepayment, contained in ELIHPA, permanent and authorized HUD to provide incentives to owners to encourage them to maintain the affordability restrictions on their properties and not prepay their mortgage loans. *See Cienega Gardens*, 33 Fed. Cl. at 204-05 (detailing the limited prepayment scheme left open under LIHPRHA). The key change caused by the enactment of ELIHPA and LIHPRHA was that owners could not prepay their mortgage loans after

twenty years without HUD approval, as had been permitted under the riders to deed of trust notes and 24 C.F.R. §§ 221.524 and 236.30 (1970). This change made it more difficult for owners to convert their properties into conventional rental properties and thereafter charge market-rate rents.

In 1996, Congress enacted the Housing Opportunity Program Extension Act of 1996 ("HOPE"), Pub.L. No. 104-120, 110 Stat. 834 (March 28, 1996). HOPE allows owners to prepay their mortgages without prior HUD approval, so long as the owners agree not to raise rents for 60 days. *See Cienega Gardens*, 38 Fed. Cl. at 70; H.R.Rep. No. 104-34 at 4, 47 (1995) (effecting H.R.2099, 104th Cong. (1995)). HOPE is not before us in this case. The Owners' claims all arose as a result of ELIHPA and LIHPRHA.

III.

Each of the Owners is a general or limited partnership that owns a low-income housing project in California and that participates in the Section 221(d)(3) or Section 236 program. *See Cienega Gardens*, 33 Fed. Cl. at 205. On January 3, 1994, a first set of Owners filed suit against the government in the Court of Federal Claims, seeking damages for breach of contract, just compensation under the Fifth Amendment for alleged takings of property, and additional compensation based on alleged unlawful administrative actions.[3] *See id.* at 202. In their breach

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[3] The original Owners that filed suit were Cienega Gardens, Cedar Gardens, Claremont Village Commons, Covina West Apartments, Del Amo Gardens, Del Vista Village, DeSoto Gardens, Independence Park Apartments, Kittridge Gardens I, Kittridge Gardens II, Las Lomas Gardens, Oxford Park, Parthenia Townhomes, Pioneer Gardens, Puente Park Apartments, Rayen Park Apartments, Reseda Park Apartments, Roscoe Park Apartments, St. Andrews Gardens, San Jose Gardens, Sherman

of contract claims, the Owners alleged that the enactment of ELIHPA and LIHPRHA breached contracts with HUD which they claimed allowed them to prepay their mortgage loans after twenty years without HUD approval. *See id.* at 205. On March 8, 1994, the government moved to dismiss for lack of jurisdiction; on the following day, the Owners moved for summary judgment.

In a March 27, 1995 opinion, the Court of Federal Claims denied the government's motion to dismiss and granted the Owners' motion for summary judgment on the breach of contract claims.[4] First, the court addressed the government's argument that it lacked jurisdiction over the breach claims because there was no privity of contract between HUD and the Owners. *See id.* The government argued that the Owners' claims were based on prepayment provisions contained in the deed of trust notes between the Owners and their lenders, not on provisions in the regulatory agreements between HUD and the Owners. *See id.* The government claimed that there was not privity of contract between HUD and the Owners because HUD was not a party to the deed of trust notes, which contained the prepayment provisions that allegedly had been breached. *See id.* The court determined that the fact that HUD was not a named party to the deed of trust notes, except as an endorser with respect to insurance, was not dispositive of the privity of contract

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Park Apartments, and Sunland Park Apartments. *See Cienega Gardens*, 33 Fed. Cl. at 205 n. 8.

[4] The Court of Federal Claims dismissed the claims for additional compensation for alleged unlawful administrative actions. *See Cienega Gardens*, 33 Fed. Cl. at 202, 223-24. In addition, the court denied both the Owners' and the government's motions with respect to the takings claims. *See id.* at 202, 213-23. Neither of these rulings is before us. The Owners' takings claims remain pending in the Court of Federal Claims.

issue. *See id.* at 210. The court held that all of the documents at issue had to be analyzed together in determining whether privity of contract existed:

> Thus, contrary to the defendant's assumptions, the "express contract" upon which plaintiffs base their claim is not to be found solely in either the deed of trust note or the regulatory agreement. The two documents, which were signed contemporaneously, must be read together in order to determine the full intentions of the parties when they initially entered into their relationship.

Id. The court determined that "when the parties [i.e., HUD and the Owners] ... entered into the regulatory agreement they also intended to be mutually bound by the prepayment rules set forth in the rider to the contemporaneous deed of trust note," and, therefore, privity of contract existed. *Id.*

The court then concluded that the Owners had established a breach of contract:

> By signing the regulatory agreement and the deed of trust note to which the regulatory agreement referred, plaintiffs promised to construct and maintain housing in accordance with the HUD's specifications, to accept only low or moderate-income persons as tenants, to charge no higher rents than those permitted by HUD, to distribute profits to shareholders in accordance with specified limitations, to make timely payments on their mortgages and to maintain cash reserves to self-insure against mortgage default. These promises were made expressly to and for the benefit of the government, not third parties. In exchange, the government agreed to endorse and insure the mortgages (allowing plaintiffs to obtain either

> subsidized commercial loans or loans at favorable interest rates) and to allow plaintiffs to free themselves of HUD's regulatory strictures after the first 20 years. Accordingly, the court finds that Congress, by enacting ELIHPA and LIHPRHA, breached the government's contracts with plaintiffs with respect to their prepayment rights.

Id. The court rejected the government's arguments that the sovereign acts doctrine,[5] the doctrine of unmistakability,[6] and lack of contracting authority[7] prevented liability. *See id.* at 211-13. Given its decision that HUD had breached its contracts with the Owners and the lack of evidence concerning damages, the court stated that a damages trial would be necessary. *See id.* at 213.

On April 10, 1995, the government moved for reconsideration of the breach of contract issue. *See Cienega Gardens v. United States*, No. 94-1C, slip op. at 1 (Fed.Cl. Apr. 13, 1995). The government argued that the riders to the deed of trust notes could be interpreted as establishing prepayment terms between the private lending institution and the Owners rather than establishing prepayment terms between HUD and the Owners, as the court had determined. *See id.* The

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[5] For an explanation of the sovereign acts doctrine, *see Bowen v. Public Agencies Opposed to Soc. Sec. Entrapment*, 477 U.S. 41, 52-53, 106 S.Ct. 2390, 91 L.Ed.2d 35 (1986); *Atlas Corp. v. United States*, 895 F.2d 745, 754 (Fed.Cir. 1990).

[6] For an explanation of the doctrine of unmistakability, *see United States v. Winstar Corp.*, 518 U.S. 839, 871-87, 116 S.Ct. 2432, 135 L.Ed.2d 964 (1996).

[7] The government contended that even if HUD intended to promise the owners that they could prepay their mortgages regardless of future legislation restricting them from doing so, the promise was unenforceable for lack of express authority from Congress.

government argued that summary judgment was inappropriate given these two possible interpretations, which it asserted created an ambiguity. *See id.* The court rejected the argument and denied the motion for reconsideration. *See id.* at 2, 4.

In an April 1, 1996 order, the Court of Federal Claims joined twenty-one "new plaintiffs" to the suit. *See Cienega Gardens*, 37 Fed. Cl. at 80.[8] The new plaintiffs' complaint raised the same three claims that had been presented by the original plaintiffs. *See id.* The government moved for summary judgment on the breach of contract and alleged unlawful administrative action claims, while the new plaintiffs moved for summary judgment on the breach of contract claims. *See id.* Based on its previous decision, the court granted the new plaintiffs' motion for summary judgment on the breach of contract claims.[9] *See id.* at 80-81, 84.

On November 18-21, 1996, the Court of Federal Claims held a trial to quantify damages. *See Cienega Gardens*, 38 Fed. Cl. at 66. As noted in footnote 1

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[8] The "new plaintiffs" were Argonaut Apartments, Beck Park Apartments, Blossom Hill Apartments, Casa San Pablo, Central Park Apartments, Drehmoor Apartments, Fairview Green Apartments, Genessee Park Apartments, Grace & Laughter Apartments, Green Hotel, Hollywood Knickerbocker Apartments, Hollywood Plaza, Kings Canyon Apartments, Lawrence Road Apartments, Livermore Gardens, Palo Alto Gardens, Pico Plaza Apartments, Placita Garden Apartments, Skyline View Gardens, Villa Fontana, and Village Green. The new plaintiffs had all entered into Section 221(d)(3) or Section 236 mortgages. *See Cienega Gardens v. United States*, 37 Fed. Cl. 79, 81 (1996).

[9] The Court of Federal Claims dismissed the claim for additional compensation for alleged unlawful administrative actions. See *Cienega Gardens*, 37 Fed. Cl. at 80, 85. That ruling is not before us. Unlike the first set of Owners, the new plaintiffs did not move for summary judgment on their takings claims. *See id.* at 85. As is the case with the original plaintiffs, the new plaintiffs' takings claims remain pending in the Court of Federal Claims.

above, the parties selected four "model plaintiffs" for purposes of litigating the damages issue. *See id.* at 67 n. 3. The model plaintiffs were (1) Sherman Park Apartments, owned by the Sherman partnership, (2) Independence Park Apartments, owned by the Independence partnership, (3) St. Andrews Gardens, owned by the St. Andrews partnership, and (4) Pico Plaza Apartments, owned by the Pico partnership. *See id.* Each of these projects is located in Los Angeles. *See id.* at 69. The court held that the model plaintiffs were entitled to breach of contract damages in the total amount of $3,061,107. *See id.* at 66, 89. In so holding, the court ruled that the Los Angeles Rent Stabilization Ordinance ("LARSO"), Ordinance No. 152,120 (codified at Ch. XV, Los Angeles Municipal Code), was preempted by LIHPRHA because LARSO conflicted with the federal scheme enacted through LIHPRHA. *See Cienega Gardens*, 38 Fed. Cl. at 82-85. The court thus determined that LARSO, which limits rental rates on certain covered properties, did not bar or limit recovery for the government's breach of contract. *See id.* at 85.

On May 15, 1997, the court ordered entry of judgment based on its decisions and stayed all proceedings on the claims of the remaining plaintiffs pending appeal. *See Cienega Gardens v. United States*, No. 94-1 C (Fed.Cl. May 15, 1997). Judgment was entered accordingly on June 18, 1997. *See Cienega Gardens*, No. 94-1 C (Fed. Cl. June 18, 1997). The government appealed on August 20, 1997. On September 8, 1997, Sherman Park Apartments, Independence Park Apartments, Pico Plaza Apartments, and St. Andrews Gardens, the four model plaintiffs, cross-appealed, challenging the court's dismissal of their claim for damages based on alleged

unlawful administrative actions.[10] We have jurisdiction pursuant to 28 U.S.C. § 1295(a)(3).

DISCUSSION

I.

Summary judgment is appropriate if "there is no genuine issue as to any material fact and . . . the moving party is entitled to a judgment as a matter of law." RCFC 56(c). We review a grant of summary judgment by the Court of Federal Claims *de novo* to determine whether the summary judgment standard has been correctly applied. *See Winstar Corp. v. United States*, 64 F.3d 1531, 1539 (Fed.Cir. 1995) (en banc), *aff'd*, 518 U.S. 839, 116 S.Ct. 2432, 135 L.Ed.2d 964 (1996) (citing *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986)); *Southfork Sys., Inc. v. United States*, 141 F.3d 1124, 1131 (Fed.Cir. 1998).

On appeal, the government raises three challenges to the decision of the Court of Federal Claims. First, it asserts that the court erred in holding that the enactment of ELIHPA and LIHPRHA breached contracts between HUD and the Owners[11] under which the Owners enjoyed an unrestricted right to prepay their HUD-insured mortgage loans twenty years after HUD's final endorsement of the loans for insurance. The government argues that HUD was not a party to

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[10] In their brief to this court, the model plaintiffs abandoned their cross-appeal. However, because they failed to file a motion to voluntarily dismiss the cross-appeal, pursuant to Fed. Cir. R. 42(b), we must dispose of the cross-appeal. Therefore, the cross-appeal, No. 97-5134, is *DISMISSED with PREJUDICE*, and the mandate shall issue forthwith.

[11] Throughout this opinion we use the term "Owners" to refer to all of the plaintiffs listed in the caption of this appeal. While the Court of Federal Claims only entered final judgment with respect to the four model plaintiffs and only those plaintiffs are before us, our analysis of the issue of liability applies to all of the plaintiffs, i.e., "Owners," not just the model plaintiffs.

any agreement that granted the Owners an unrestricted prepayment right and that therefore it was not in privity with the Owners. It contends that the twenty- year unrestricted prepayment right appeared in the deed of trust notes, which HUD endorsed but to which it was not a party, and that neither the insurance commitments issued by HUD nor the regulatory agreements between HUD and the Owners contained or referenced any prepayment terms or conditions. The government argues that, because there was no privity of contract between HUD and the Owners, the court lacked jurisdiction with respect to the Owners' breach of contract claims. Second, the government challenges several aspects of the damages award. Third, it argues that the court erred in holding that LARSO was preempted by ELIHPA and LIHPRHA. Accordingly, the government urges, LARSO would have limited the rents that the Owners could have charged after prepayment, thereby reducing the amount of lost profits suffered as a result of any breach of contract. Because we resolve this appeal in favor of the government based on the jurisdiction issue, we do not address the government's second and third arguments.

II.

Under the Tucker Act, the Court of Federal Claims has jurisdiction over claims based on "any express or implied contract with the United States." 28 U.S.C. § 1491(a)(1) (1994). We have stated that "[t]o maintain a cause of action pursuant to the Tucker Act that is based on a contract, the contract must be between the plaintiff and the government...." *Ransom v. United States*, 900 F.2d 242, 244 (Fed.Cir. 1990). In other words, there must be privity of contract between the plaintiff and the United States. *See Erickson Air Crane Co. v. United States*, 731 F.2d 810, 813

(Fed.Cir.1984) ("The government consents to be sued only by those with whom it has privity of contract."). The effect of finding privity of contract between a party and the United States is to find a waiver of sovereign immunity. *See National Leased Hous. Ass'n v. United States*, 105 F.3d 1423, 1436 (Fed.Cir.1997) (*National Leased Housing*). Whether a contract exists is a mixed question of law and fact. *See Ransom*, 900 F.2d at 244. Since the parties do not dispute the relevant facts, the privity issue reduces to a question of law, which we review *de novo*. Contract interpretation itself also is a question of law, which we review *de novo*. *See Winstar*, 64 F.3d at 1540; *Massachusetts Bay Transp. Auth. v. United States*, 129 F.3d 1226, 1231 (Fed.Cir.1997).

A.

We begin our analysis with the documents underlying the transactions at issue. In doing so, we focus on the documents relating to the four model plaintiffs, each of whom developed and operated a low-income rental housing project with a mortgage loan insured by HUD pursuant to Section 221(d)(3) or Section 236. *See Cienega Gardens*, 38 Fed. Cl. at 67.

The transactions at issue were accomplished as follows: First, pursuant to 24 C.F.R. § 221.509(a) or § 236.1 (1970), each of the Owners received a "Commitment for Insurance of Advances" from the Federal Housing Commissioner, acting on behalf of the Secretary of HUD. The commitment provided that the Commissioner would endorse for insurance a mortgage note in a specified amount. The specified amount represented the total amount of advances that were to be made to the Owner by a specified lending institution pursuant to a loan agreement between the Owner and the institution. Thus, the commitment stated: "Upon completion of the project in accordance with the Drawings and Specifications the mortgage note will be

finally endorsed for insurance to the extent of the advances of mortgage proceeds approved by the Commissioner, subject to reduction as provided in the Regulations." The commitment further provided that "[t]he insurance endorsement will be subject to compliance with the requirements of the Regulations, [*i.e.*, the HUD regulations in effect at the time] and the terms and conditions set forth" in the commitment. The commitment required that the Owner enter into a regulatory agreement or other instrument "to permit the Commissioner's regulation of the Mortgagor as to rents, charges, and methods of operation." The regulatory agreement requirement was consistent with the pertinent regulations, which allowed the Commissioner to regulate the mortgagor for as long as HUD insured the mortgage loan. *See* 24 C.F.R. §§ 221.529, 236.1 (1970). The commitment also provided that "[a]ll certificates, documents and agreements called for by this commitment shall be on forms approved or prescribed by the Commissioner."

Pursuant to the commitment that it had received from HUD, at an initial closing, the Owner executed a "Deed of Trust Note." The deed of trust note established a mortgage loan between the Owner and a specified private lending institution. The deed of trust note was endorsed by HUD. The endorsement indicated that the Owner's mortgage loan had been approved for insurance by HUD. The note also incorporated an attached rider, referred to as "Rider A." Rider A to the Sherman Park Apartments note provided:

> This Rider is attached to and made a part of Deed of Trust Note dated November 2, 1970, by and between SHERMAN PARK APARTMENTS, a partnership, Maker [,] and UNITED CALIFORNIA BANK, Payee.

> The debt evidenced by this Deed of Trust Note may not be prepaid, either in whole or in part, prior to the final maturity date hereof without the prior written approval of the Federal Housing Commissioner, except a maker which is a limited distribution mortgagor may prepay without such approval after twenty (20) years from the date of final endorsement of this Deed of Trust Note by the Federal Housing Commissioner.

The riders to the notes of Pico Plaza Apartments, St. Andrews Gardens, and Independence Park Apartments contained similar opening paragraphs and provided:

> The debt evidenced by this Deed of Trust Note may not be prepaid, either in whole or in part, prior to the final maturity date hereof without the prior written approval of the Federal Housing Commissioner, except where: (1) the prepayment is in connection with the release of an individual unit for sale to a lower income, elderly, or handicapped person; or (2) the Maker is a limited distribution mortgagor which is not receiving payments from the Commissioner under a rent supplement contract pursuant to Section 101 of the Housing and Urban Development Act of 1965, and the prepayment occurs after the expiration of twenty (20) years from the date of final endorsement of this Deed of Trust Note by the Commissioner or as a result of a sale of the project to a cooperative or nonprofit corporation or association and the purchase is financed with a mortgage insured pursuant to Section 236(j)(3) of the National Housing Act as amended.

Simultaneously with the execution of the deed of trust note, the Owner executed a "Deed of Trust." The deed of trust secured payment of the indebtedness evidenced by the deed of trust note by granting the relevant lending institution a mortgage on the project property. In the deed of trust, the Owner covenanted

> [t]hat the Regulatory Agreement, if any, executed by the Trustor and the Federal Housing Commissioner, which is being recorded simultaneously herewith, is incorporated in and made a part of this Deed of Trust. Upon default under the Regulatory Agreement and upon the request of the Federal Housing Commissioner, the Beneficiary [i.e., the private lending institution], at its option, may declare the whole of the indebtedness secured hereby to be due and payable.

The quoted language was contained in the Sherman Park Apartments deed of trust; the other deeds of trust contained substantially similar language.

Simultaneously with the execution of the deed of trust and the deed of trust note, the Owner and HUD entered into the regulatory agreement. The regulatory agreement stated in the preamble that the Owner was entering into the agreement "[i]n consideration of the endorsement for insurance by the Commissioner of the [deed of trust] note . . . and in order to comply with the requirements of Section 221(d)(3) [or Section 236] of the National Housing Act, as amended, and the Regulations adopted by the Commissioner pursuant thereto." In the regulatory agreement, the Owner agreed to comply with all "Federal, State, or local law prohibiting discrimination in housing on the grounds of race, color, creed, or national origin, including Title VI of the Civil Rights Act of 1964, [and] "all requirements imposed by or pursuant to the Regulations of the Department of

Housing and Urban Development (24 CFR, Subtitle A, Part 1) issued pursuant to that title" for "so long as the contract of mortgage insurance continues in effect."

Although the regulatory agreement was signed on behalf of the Owner and HUD, it was the Owner who assumed obligations under the agreement. By signing the regulatory agreement, the Owner agreed to timely make all payments due under the deed of trust note and to set aside cash reserves to minimize the likelihood of default on the note. The regulatory agreement also contained numerous undertakings by the Owner with respect to management of the covered project. In addition, in the regulatory agreement, the Owner agreed to restrictions on the income levels of tenants, restrictions on allowable rental rates, and restrictions on the rate of return the Owner could receive from the project.

The question before us is whether the transaction framed by the commitment, the deed of trust note, the deed of trust, the loan agreement, and the regulatory agreement, each of which was in a form approved by HUD, gave rise to privity of contract between HUD and the Owner insofar as the right to prepay the mortgage loan was concerned. We conclude that it did not.

B.

It has never been argued that HUD failed to provide mortgage insurance, as required by each "Commitment for Insurance of Advances." In other words, it is undisputed that HUD discharged its obligations to the Owners under the various commitments. Thus, as the Court of Federal Claims recognized, *see Cienega Gardens*, 33 Fed. Cl. at 208-10, the question of whether the requirement of privity of contract was satisfied turns, in the case of each Owner, on consideration of the deed of trust note and the

regulatory agreement. In approaching this question, we are mindful that, in order to find privity of contract, we must find on the part of HUD "the type of direct, unavoidable contractual liability that is necessary to trigger a waiver of sovereign immunity, the inevitable result of finding privity of contract." *National Leased Housing*, 105 F.3d at 1426.

We start from the premise that the United States, i.e., HUD, was a named party to only one contract in connection with each of the relevant projects, that contract being the regulatory agreement. Moreover, in that regard, as just seen, it was the Owner, not HUD, that assumed obligations under the regulatory agreement. The regulatory agreement did not incorporate any other agreement, including the deed of trust note or Rider A to the deed of trust note. Neither did the regulatory agreement mention prepayment of the mortgage loan or incorporate any agreement or provision addressing prepayment.

It is true that *Thetford Properties IV Ltd. Partnership v. U.S. Dep't. of Hous. & Urban Dev.*, 907 F.2d 445 (4th Cir.1990), states that the regulatory agreements at issue in that case "expressly allowed the owners of [the] properties, without HUD's prior consent, to prepay their mortgages at the end of 20 years, thereby terminating HUD insurance and withdrawing the properties from the program." 907 F.2d at 446 (citing 24 C.F.R. § 221.524(a)(1989)) We attach little significance to this statement, however. *Thetford* involved a suit by owners of low-income housing projects with mortgage loans insured pursuant to section 221(d)(3). The owners sought a declaration that ELIHPA's restrictions upon prepayment of their mortgage loans violated their constitutional right to due process of law. *Id.* at 447. The district court dismissed the complaint after concluding that the

owners had failed to exhaust their administrative remedies. *Id.* The court of appeals affirmed the dismissal without reaching the merits of the owner's claims. *Id.* at 450. The statement quoted above appears at the beginning of the opinion in a discussion of the statutory background. Because privity of contract was not at issue in *Thetford*, the quoted statement is properly viewed as *dictum*. Most importantly, however, the regulatory agreements before us contain no provisions relating to prepayment.

The only document that addressed prepayment was the deed of trust note, with its attached Rider A. However, the agreement represented by each deed of trust note was between the relevant Owner and its private lending institution, as evidenced by the recitals at the beginning of the note. Thus, each deed of trust note began with the statement "FOR VALUE RECEIVED, the undersigned promise(s) to pay to [name of lending institution] ... the principal sum of [the amount of the loan]...." Although HUD did provide its insurance endorsement, it was not expressly made a party to any deed of trust note or its attached Rider A.

Each deed of trust note was incorporated by reference into the applicable deed of trust. The deed of trust too represented a contract between the relevant Owner and its private lending institution, as evidenced by the recitals at the beginning of the deed of trust naming the relevant Owner and the lending institution. Each deed of trust also incorporated a rider, which was attached to it. The deed of trust and the rider incorporated the regulatory agreement by reference. However, the incorporation of the regulatory agreement--which set forth obligations on the part of the Owner--into the rider to the deed of trust did not make HUD a party to the deed of trust.

While recognizing the above, the Court of Federal Claims determined that all of the pertinent documents had to be construed together in order to determine the intent of the parties:

> Because the rider [to the deed of trust note] specifically allocated certain rights between HUD and plaintiffs, the fact that HUD was not a named party (except as an endorser) to the deed of trust note containing the rider is not dispositive of the issue of privity of contract between the parties in this action. The government's participation as a party to the deed of trust note is unnecessary to establish privity of contract with respect to plaintiff's prepayment rights.
>
> Thus, contrary to the defendant's assumptions, the "express contract" upon which plaintiffs base their claim is not to be found solely in either the deed of trust note or the regulatory agreement. The two documents, which were signed contemporaneously, must be read together in order to determine the full intentions of the parties when they initially entered into their relationship.

Cienega Gardens, 33 Fed. Cl. at 210 (footnote omitted). In support of this statement, the court relied on *Restatement (Second) of Contracts* § 202(2) (1981), which provides, "A writing is interpreted as a whole, and all writings that are part of the same transaction are interpreted together." The comment to this section states that this Rule in Aid of Interpretation does "not depend upon any determination that there is an ambiguity, but [is] used in determining what meanings are reasonably possible as well as in choosing among possible meanings." *Id.* at cmt. b. We agree with the Court of Federal Claims that all of the agreements

before us are relevant in determining the meaning of each separate contract. However, we cannot sustain the court's conclusion that "when the parties in this case [i.e., the Owners and HUD] entered into the regulatory agreement they also intended to be mutually bound by the prepayment rules set forth in the rider to the contemporaneous deed of trust note." *Cienega Gardens*, 33 Fed. Cl. at 210.

While the deed of trust note (and the incorporated Rider A) and the regulatory agreement were part of the same transaction, each document stands alone and is unambiguous on its face. The documents evidence separate agreements between distinct parties. The Court of Federal Claims erred in importing requirements from the deed of trust note and the accompanying rider into the regulatory agreement. The regulatory agreement, which was a document under which the Owner assumed obligations, did not address prepayment, and the court erroneously read the prepayment terms contained in the deed of trust note and Rider A, between the private lending institutions and the relevant Owner, into the regulatory agreement between HUD and the Owner. The critical point is that the contract documents simply do not show privity of contract between the Owners and HUD with respect to a right to prepay the mortgage loans after twenty years without HUD approval.

C.

At the time the various agreements were executed, the regulation governing prepayment under the Section 221(d)(3) program provided:

> (a) *Prepayment in full* --(1) *Without prior Commissioner consent.* A mortgage indebtedness may be prepaid in full and the Commissioner's controls terminated without the prior consent of the Commissioner in the

following cases:

* * * * *

(ii) Where the mortgagor is a limited distribution type, which is not receiving payments from the Commissioner under a rent supplement contract executed pursuant to the provisions of §§ 5.1 *et seq.*. of this title, and where the prepayment occurs after the expiration of 20 years from the date of final endorsement of the mortgage.

24 C.F.R. § 221.524 (1970). The regulation governing prepayment under the Section 236 program provided:

(a) *Prepayment in full* –(1) *Without prior Commissioner consent.* A mortgage indebtedness may be prepaid in full and the Commissioner's controls terminated without the prior consent of the Commissioner where the mortgagor is a limited distribution type and either of the following conditions is met:

(i) If the prepayment occurs after the expiration of 20 years from the date of final insurance endorsement of the mortgage, provided the mortgagor is not receiving payments from the Commissioner under a rent supplement contract executed pursuant to the provisions of §§ 5.1 et seq. of this title.

24 C.F.R. § 236.30 (1970). While these regulations permitted prepayment after twenty years without HUD approval, the regulations were expressly subject to amendment:

The regulations in this subpart may be amended by the Commissioner at any time and from time to time, in whole or in part, but such amendments shall not adversely affect the

> interest of a mortgagee or lender under the contract of insurance on any mortgage or loan already insured and shall not adversely affect the interests of a mortgagee or lender on any mortgage or loan to be insured on which the Commissioner has made a commitment to insure.

24 C.F.R. §§ 221.749, 236.249 (1970).

The regulations governing the Section 221(d)(3) and Section 236 programs further support our conclusion that there was no privity of contract between HUD and the Owners with respect to prepayment of the deed of trust notes. The Court of Federal Claims concluded that "when the parties in this case entered into the regulatory agreement they also intended to be mutually bound by the prepayment rules set forth in the rider to the contemporaneous deed of trust note." *Cienega Gardens*, 33 Fed. Cl. at 210. However, it would have been inconsistent for HUD to have entered into the regulatory agreement if the agreement fixed the prepayment rights of the Owners, in view of the express power to amend the Section 221(d)(3) and Section 236 program regulations at any time that was reserved to HUD, subject only to the caveat that *mortgagees'* interests not be adversely affected. *See* 24 C.F.R. §§ 221.749, 236.249 (1970).

III.

A.

The Owners cite to several portions of the legislative history of ELIHPA and LIHPRHA, which they argue support their claim for breach of contract and show that Congress understood that these statutory enactments would breach contracts between HUD and the Owners. We need not address this argument in detail. It is sufficient to state that the statements in the legislative histories of ELIHPA and LIHPRHA cannot alter the content of the documents

on which the Owners attempt to base their contractual claims. The after-the-fact views of various parties cannot create a contractual relationship between HUD and the Owners with respect to prepayment terms, where the contractual documents themselves fail to evidence such a relationship.

B.

The Owners also argue that HUD's intimate involvement with the projects at issue created privity of contract with respect to the prepayment terms in the riders attached to the deed of trust notes:

> The government's contention that the prepayment provision was a matter of contract solely between the Owner and the lender/mortgagee also ignores HUD's intimate involvement with all aspects of the agreement. HUD conceived the structure of the transaction, prescribed and approved all of the relevant documents (including the Note and its rider), and furnished most of the specific language.

(Appellees' brief at 19-20.) HUD's involvement in the various transactions underlying this case, however, did not, as a matter or law, give rise to privity of contract with respect to the right to prepay the mortgage loans.

In *Dana Construction, Inc. v. United States*, 229 Ct.Cl. 862 (1982), the court stated that "it is settled that there is no privity of contract between the U.S. and a public housing contractor based on the U.S. Housing Act." *Id.* at 863. The court also stated: "That the Federal Government has intimate control over a project, including prior approval of plans and costs, does not establish liability here for claims by a contractor." *Id.* In *Dana Construction*, the court held that a construction contractor who had contracted with an agency that received federal funding to build a low-income housing project did not have privity of

contract with, and could not assert a claim for breach of contract against, HUD. *See id.* In *Housing Corporation of America v. United States*, 199 Ct.Cl. 705, 468 F.2d 922 (Ct.Cl.1972), the court addressed a contract claim by a contractor that had entered into an agreement with a state authority, subsidized by HUD. *See id.* at 924. While HUD and the state authority contracted that HUD would lend money to the state authority, *See id.* at 923, and the contract between the state authority and the contractor was on a HUD-approved form, *See id.*, the court ruled that there was no privity of contract between the contractor and HUD because HUD was not a party to any contract with the contractor, *See id.* at 924, 926. In *National Leased Housing*, *supra*, the owners of rental properties entered into Housing Assistance Program contracts, some directly with HUD and some via HUD-approved contracts with public housing agencies. 105 F.3d at 1425. The court held that owners who entered into the two-tier contract scheme, *i.e.*, contracted with public housing agencies rather than directly with HUD, lacked privity of contract with HUD, while owners who contracted directly with HUD had privity of contract. *See id.* at 1437. In so ruling, the court noted that HUD's obligations under the two-tier contract scheme were directed toward the public housing agencies rather than the owners. The court determined that, under the two-tier scheme, HUD had no direct contractual relationship with the owners and that therefore there was no privity of contract with the owners. *See id.* at 1436-37.

In *Dana Construction* and *Housing Corporation of America*, the government was not a party to any agreement with the contractor who was seeking recovery from the United States. The same was true with respect to the project owners who entered into the two-tier contract scheme in *National Leased Housing*. That is different from this case, where HUD entered

into the various regulatory agreements. These cases do make it clear, however, that in order for the government to be liable for breach of contract, there must be privity of contract and that the degree of HUD involvement with a project does not create privity so as to allow suit against the government. The Owners' contention that HUD's involvement with the transactions at issue resulted in privity of contract thus fails.

The Owners did have contractual relationships with HUD via the various regulatory agreements. As seen above, however, the contract evidenced by each of the regulatory agreements was limited in scope to obligations on the part of the Owner that were in consideration for HUD having endorsed the deed of trust note which evidenced the loan to the Owner from its lending institution. Although there was a contract - the regulatory agreement - between each of the Owners and HUD, the Owners' claims are based on the prepayment terms in the deed of trust notes and the attached riders. HUD and the Owners had no contractual relationship with respect to prepayment rights, and HUD's involvement in the contracts between the private lending institutions and the Owners could not create such a contractual relationship.

C.

Finally, the Owners contend that this case is controlled by, or analogous to, *Winstar Corp. v. United States*, 64 F.3d 1531 (Fed.Cir.1995) (en banc), *aff'd*, 518 U.S. 839, 116 S.Ct. 2432, 135 L.Ed.2d 964 (1996). In *Winstar*, this court held that the government had breached its express contracts with various financial institutions through the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), Pub.L. No. 101-73, 103 Stat. 183 (1989) (codified in relevant part at 12 U.S.C. § 1464).

See Winstar, 64 F.3d at 1534. Each of the financial institutions had contracted with the government for approval to purchase failing thrifts. At the same time, each institution also had contracted for approval, in the process, (i) to use supervisory goodwill toward its minimum regulatory capital requirements and (ii) to amortize the goodwill over periods of up to forty years. *See id.* at 1536. We held that each financial institution had entered into an express agreement with the government and that, by virtue of an integration clause, each contract incorporated contemporaneous documents that expressly permitted the accounting treatment at issue.[12] *See id.* at 1540-44. We then determined that the enactment of FIRREA breached these express agreements. *See id.* at 1544. The plaintiffs in *Winstar* had contracts with integration clauses that expressly incorporated contemporaneous documents that allowed them to use supervisory goodwill and the stated amortization periods. The Owners in the present case can point to no similar contractual provisions. The regulatory agreements do not address prepayment and do not contain integration clauses that incorporate any document addressing prepayment. In fact, no documents between HUD and the Owners address prepayment. The deed of trust notes and the attached Riders A were not incorporated

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[12] For example, one of the contracts contained an integration clause that, in relevant part, provided:

> This Agreement, together with an interpretation thereof or understanding agreed to in writing by the parties, constitutes the entire agreement between the parties thereto and supersedes all prior agreements and understandings of the parties in connection herewith, *excepting only the Agreement and Merger and any resolutions or letters issued contemporaneously herewith by the [Bank Board] or the FSLIC* . . . .

Winstar, 64 F.3d at 1540 (emphasis added).

into the regulatory agreements by reference, nor was HUD a party to the deed of trust notes and incorporated riders. The regulatory agreements, which set forth obligations on the part of the Owners, merely referenced HUD's role as endorser for insurance of the mortgage loans. *Winstar* provides no support for the Owners' claims.

IV.

We hold that there was no privity of contract between HUD and the Owners with respect to prepayment of the deed of trust notes. Pursuant to each "Commitment for Insurance of Advances," HUD contracted to provide mortgage insurance, but did not agree to any prepayment terms. Neither were there any prepayment terms in the regulatory agreements between HUD and the Owners. The only contractual prepayment terms were contained in the deed of trust notes and the attached riders, to which HUD was not a party. Because there was no privity of contract between HUD and the Owners with respect to prepayment of the deed of trust notes, HUD could not be liable to the Owners for breach of contract by reason of the enactment of ELIHPA and LIHPRHA. Thus, the Court of Federal Claims erred in granting summary judgment in favor of the Owners on their breach of contract claims. The court should have granted summary judgment in favor of the government on the breach of contract claims.

CONCLUSION

For the foregoing reasons, we vacate the judgment in favor of the four model plaintiffs. The case is remanded to the Court of Federal Claims, which is directed (i) to enter judgment in favor of the government on the Owners' breach of contract claims, (ii) to dismiss the breach of contract claims, and (iii) to

conduct such further proceedings, consistent with this opinion, as may be necessary.

COSTS

Each party shall bear its own costs.

VACATED and *REMANDED* with *INSTRUCTIONS*

ARCHER, Senior Judge, dissenting.

The decision of the Court of Federal Claims holding that the government breached its contracts with the plaintiffs (Owners) should, in my view, be affirmed. The Court of Federal Claims (CFC) correctly held that the Owners were promised the right, and therefore entitled, to prepay their mortgages on these low and moderate-income housing projects without HUD approval after twenty years, as set forth in Rider A to the Deed of Trust Notes. This contract right was breached when Congress enacted statutes, commonly referred to as ELIHPA and LIHPRHA, that prevented them from prepaying their mortgages without HUD's approval.

The majority holds there was no privity of contract between HUD and the Owners. Even though Rider A to the Notes expressly provided that the Owners could elect to prepay the mortgage after twenty years without HUD approval, the majority reasons that this does not bind the government because the Notes were contracts between the lenders and Owners and were only endorsed for insurance by HUD. The majority also holds that the Owners cannot rely on the provisions of the HUD regulations in effect at the time these transactions took place, which also permitted prepayment without HUD approval after twenty years, because the regulations were amendable. I think the majority has reached the wrong conclusion in each instance.

In analyzing each of the pertinent agreements separately, the majority has not considered critical factors which support the CFC's conclusion that the government intended and in fact did bind itself to the prepayment provisions. Principally, these factors are the overall purpose and nature of the transactions, the intent of the parties, the terms and conditions of HUD's Commitments for Insurance of Advances, and the references in the HUD's Commitments and endorsements of the Notes to specific, dated HUD regulations governing these transactions.

A.

The purpose of the HUD low and moderate-income housing programs fully supports the CFC's decision. At the time these transactions occurred, Congress and HUD were encouraging private parties to construct low and moderate-income housing with subsidized or low interest rate loans guaranteed by the government. *See, e.g.*. H. Rep. No. 90-1585 at 2, 21 (1968). In turn, the Owners were severely restricted as to the rents they could charge and the income they could earn from these projects. *See* 24 C.F.R. § 207.253(a)(2)(1970). These disincentives were offset, however, by the fact that after twenty years the Owners would be permitted to repay the mortgages without prior approval of HUD and at the same time be relieved from the government's rent and profit restrictions. Thus, after the twenty year period, the Owners would be able to charge market rates for the housing units. It is undisputed that the Owners, lenders and HUD all entered into these transactions with the full knowledge and intent that the Owners would repay the mortgages after the twenty year period if it was economically advantageous to them. *See Cienega Gardens v. United States*, 38 Fed. Cl. 64, 75 (1997).

The nature and mechanics of the transactions required by the HUD programs support the CFC's decision as well. Projects under these programs were commenced by applying to HUD for the issuance of a Commitment for Insurance of Advances to the Owners and the lenders. In accordance with the regulations, both the Owners and the lenders had to make application for the Commitment. The regulations specifically provided:

> An application for issuance of either a conditional or firm commitment for insurance of a mortgage on a project shall be submitted by an approved mortgagee and *by the sponsors* of such project.

See 24 C.F.R. § 221.502(a), § 236.5(a)(1970) (emphasis added).

The Commitments issued by HUD to the Owners, as well as the lenders, was in the nature of an offer to provide mortgage insurance when the specific requirements set forth in the Commitments were completed. HUD was then contractually obligated to place its insurance endorsement on the Notes.

The Owners were required to provide a number of documents and agreements, all of which were prescribed and/or approved by HUD as to form and content. Among these were the documents relating to the mortgage loan, including the Deed of Trust (FHA Form 4104-G) and the Deed of Trust Note (FHA Form 4104-e). In this connection, HUD furnished additional language to the Notes in the form of Rider A. Rider A specifically provided that the Owners could prepay the Notes after twenty years without HUD's consent. The Rider also contained restrictions on prepayment by the Owners in the absence of HUD approval, during the first twenty years of the mortgage.

B.

The CFC carefully examined the nature and purpose of the low and moderate-income housing statutes and regulations, the specific documents executed to carry out the transactions and other evidence of record. Based on all of the documents and evidence, the court determined that "when the parties ... entered into the regulatory agreement they also intended to be mutually bound by the prepayment rules set forth in the rider to the contemporaneous deed of trust note." *Cienega Gardens v. United States*, 33 Fed. Cl. 196, 210 (1995). The court noted the various promises made by the Owners to HUD and the government's concurrent promises to the Owners, as follows:

> By signing the regulatory agreement and the deed of trust note to which the regulatory agreement referred, plaintiffs promised to construct and maintain housing in accordance with the HUD's specifications, to accept only low or moderate-income persons as tenants, to charge no higher rents that those permitted by HUD, to distribute profits to shareholders in accordance with specified limitations, to make timely payments on their mortgages and to maintain cash reserves to self-insure against mortgage default. These promises were made expressly to and for the benefit of the government, not third parties. In exchange, the government agreed to endorse and insure the mortgages (allowing plaintiffs to obtain either subsidized commercial loans or loans at favorable interest rates) and to allow plaintiffs to free themselves of HUD's regulatory strictures after the first 20 years. Accordingly, the court finds that Congress, by enacting ELIHPA and LIHPRHA, breached the government's contracts with plaintiffs with respect to their

prepayment rights.

Id. at 210.

In reaching the conclusion that contracts between HUD and the Owners had been breached by the enactment of ELIHPA and LIHPRHA, the Court of Federal Claims considered whether Rider A to the Notes created contractual rights between HUD and the Owners and whether there was privity of contract as to these provisions. The court expressly found that the provisions of Rider A were intended to create contractual rights between these parties, even thought the named parties to the Notes were the Owners and the lenders. It reasoned that there was privity of contract between the Owners and HUD as to the prepayment provisions because mutual rights and obligations were set forth in the Rider. The court stated:

> As discussed earlier, the rider gave HUD the right to approve or disapprove prepayment prior to the first twenty years following HUD's endorsement, and the rider allowed prepayment without HUD approval after the first twenty years. *Despite the fact that HUD was not a named party the deed or trust note--the fact upon which defendant's privity argument rests--the rider gave the lender no right whatsoever to interfere with an owner's plan to prepay. The rider gave that power only to HUD, and only permitted such interference during the first 20 years of the mortgage. Because the rider specifically allocated certain rights between HUD and plaintiffs, the fact that HUD was not a named party (except as an endorser) to the deed of trust note containing the rider is not dispositive of the issue of privity* of contract between the parties in this action. The

> government's participation as a party to the deed of trust note is unnecessary to establish privity of contract with respect to plaintiff's prepayment rights.

Id. at 209-210 (emphasis added).

The CFC concluded that the parties, including HUD, intended to be bound by the prepayment provision set forth in Rider A. The court's effort to find the parties' intent based on all of the documents and the surrounding facts and circumstances was entirely appropriate in complex integrated transactions of this sort, where multiple parties executed multiple documents at closing. Here, there were two such closing sessions, the first when HUD gave its initial endorsement permitting the projects to be constructed and the second when HUD gave its final endorsement after the projects were completed.

The fallacy in the majority's analysis is that it has considered each of the documents necessary to fulfill the term of the Commitments in virtual isolation. By narrowly interpreting each agreement in this stand-alone fashion, I think the majority has come to the wrong result as to the Owners' privity with HUD and as to HUD's intention and contractual obligation at the time these agreements were executed.

Accordingly, I would accept the Court of Federal Claim's factual findings that the relevant parties, HUD and the Owners, intended to bind themselves to the prepayment provisions as set forth in Rider A.

C.

I am also convinced that the Commitments and subsequent endorsements by HUD of the Notes in these transactions establish as a matter of law the requisite privity between the Owners and HUD to find an enforceable express contract as to the prepayment right. As noted above, HUD's Commitment was issued

to the Owners as well as to the lenders. It provided that if the enumerated conditions were met and the required documents in the form prescribed or approved by HUD were furnished and executed to HUD's satisfaction, HUD would be obligated to insure and endorse the Notes. One of the HUD approved provisions was Rider A. In Rider A, HUD obtained control in a contractual document over any proposed prepayment by the Owners during the first twenty years of the mortgage, and because this control was set forth in the Notes themselves the lenders were put on notice of HUD's controlling position. Similarly, the Owners' prepayment rights after twenty years were made known to the lenders.

When HUD endorsed the Notes with these provisions, HUD was fulfilling its Commitment obligations and thereby giving approval to all of the underlying documents and executed agreements that were conditions to its endorsements. Because HUD sought to obtain, and did obtain in the Notes that it approved, the right from the Owners for this control over any proposed prepayment until after the 20th year, it effectively became a party by its endorsements of the Notes as to the prepayment provisions. In my view, the privity of contract as to the dominant Commitment contracts carried over to the underlying documents HUD required for its endorsements and insurance of the Notes insofar as those documents contained provisions benefiting HUD or in which HUD approved rights beneficial to the Owners.

D.

Finally, the judgment of the Court of Federal Claims should, in all events, be affirmed because the Owners were entitled to prepayment rights after twenty years under the provisions of the HUD regulations in effect at the time HUD issued its

Commitments and endorsed the Notes. The majority has rejected this position on the ground that the regulations contained a section permitting the regulations to be amended. Because these transactions were consummated under the provisions of regulations in effect as of specific dates, I believe the majority has erred.

In the HUD Commitments accepted by the Owners, which as noted were the dominant contracts, HUD expressly stated that the insurance endorsements would be made under the pertinent provisions of the National Housing Act and "the Regulations thereunder *now in effect.*" (Emphasis added.) When HUD endorsed the Notes the endorsements contained written or typed in dates, corresponding to the Commitment dates, showing that the endorsements were made under the regulations "in effect" on the Commitment dates. These provisions indicate that HUD did not intend that any subsequent amendment to the regulations would be applicable to the particular Commitment contracts and Note endorsements. It is undisputed that the regulations referred to in these documents expressly permitted Owners to prepay their mortgage notes after twenty years without HUD's consent and thereby be relieved of restrictions on rentals and profits.

Contrary the majority's holding, the fact that HUD reserved the right in 24 C.F.R. §§ 221.749, 236.249 (1970) to amend its regulations respecting prepayment generally does not permit it to do so when the Commitments as well as the Note endorsements provide that the regulations in effect on a specific date were to be applicable. The judgment of the Court of Federal Claim is also sustainable on the grounds that the prepayment provisions of the regulations in effect

on the date of HUD's Commitments were controlling and binding on the government.

APPENDIX B

UNITED STATES COURT OF FEDERAL CLAIMS

Nos. 94-1C

CIENEGA GARDENS, ET AL., PLAINTIFFS

v.

UNITED STATES, DEFENDANT.

[Decided March 27, 1995]

OPINION

Before: ROBINSON, Judge:

This case is before the court on defendant's motion for dismissal and plaintiff's cross-motion for partial summary judgment. Plaintiffs' complaint seeks damages for breach of contract (Count I), just compensation for a taking under the Fifth Amendment to the United States Constitution (Count II), and additional compensation based on allegedly unlawful administrative actions (Count III). Oral argument was held on November 30, 1994.

When the court considers matters presented by the parties outside of the pleadings, as it has in this case with respect to Counts I and II, it must treat defendant's motion to dismiss as a motion for summary judgment. The disposition of a case on a motion for summary judgment is appropriate where there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. Rule 56(c) of

the Rules of the United States Court of Federal Claims ("RCFC"). In evaluating a motion for summary judgment, the court must resolve any doubt about the existence of a material factual issue in favor of the nonmoving party. *Housing Corp. of America v. United States*, 199 Ct.Cl. 705, 710, 468 F.2d 922, 924 (1972). Applying these standards, the court now grants defendant's motion for dismissal only with respect to Count III, plaintiffs' claim for damages for allegedly unlawful administrative actions. Plaintiffs' partial motion for summary judgment is granted with respect to Count I, plaintiffs' breach of contract claim; the court agrees with plaintiffs that trial is necessary to determine the damages, if any, flowing from defendant's breach. Finally, with regard to Count II, the taking claim, both parties' motions are denied.

Factual Background

During the 1950s and 1960s, Congress enacted legislation to encourage private developers to construct, own and manage housing projects for low and moderate-income families. To implement the legislation, Congress authorized first the Federal Housing Administration and later the Department of Housing and Urban Development ("HUD" or "the agency")[1] to provide mortgage insurance to enable private lending institutions to provide low-interest mortgages to housing developers.

Housing developers also received financial incentives along with mortgage insurance, under either of two programs. The first, referred to as "Section 221," provided for below-market mortgage rates. Pub.L. 83-560, 68 Stat. 590, 597 (1954), *amended* by Pub.L.

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[1] In 1965, the Federal Housing Administration, headed by the Federal Housing Commissioner, was subsumed into the newly established Department of Housing and Urban Development. *See* 24 C.F.R. §§ 200.1-200.4 (1994).

87-70, 75 Stat. 149 (1961). Developers who obtained mortgages after 1968, however, were subject to a new provision enacted that year known as "Section 236." Developers who participated in Section 236 received market-rate mortgages with an interest subsidy. Pub.L. 90-448, § 201(a), 82 Stat. 476, 498, 499 (1968). In either case, developers were expected to pass these financial benefits on to their tenants in the form of lower rents. *Id.*

Typically, when a developer received a HUD-insured mortgage under one of these programs, the developer signed a long-term deed of trust note[2] with a private lender; HUD endorsed the note. The repayment period on the loan was 40 years. Simultaneously, the developer entered into a "regulatory agreement" with the agency which placed certain conditions on the mortgages. Most importantly, the regulatory agreement imposed restrictions on the income levels of tenants, on the rents that could be charged, and on the rates of return that the developer could receive (collectively, "affordability restrictions"). The regulatory agreement imposed upon the owners several additional obligations, including a requirement to make all mortgage payments to lenders when due and to maintain substantial cash reserves--obligations which were designed to limit the government's financial exposure under its insurance contract.[3] The regulatory

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[2] This opinion, for the sake of convenience, uses the terms "mortgage" and "deed of trust note" interchangeably, although the court is aware of their distinctions, which are rooted in state law. *See Black's Law Dictionary*, 5th ed., at 373 (West 1979).

[3] Plaintiffs also draw the court's attention to paragraph 12 of the regulatory agreement, which effectively placed a lien on the mortgaged property in favor of HUD:

> [T]o secure the Commissioner because of his liability under the endorsement of the note for insurance, and as security for the other obligations under this Agreement, the

agreement, as well as the mortgage insurance provided by HUD, was to remain in effect as long as the mortgage loan remained outstanding.

The regulatory agreement made no mention of the owner's prepayment rights. However, a rider to the HUD-endorsed deed of trust notes expressly prohibited prepayment of the mortgages before 20 years from the date of endorsement, except under certain conditions which included HUD approval of the prepayment. The notes further stated that, after making payments for 20 years, owners could prepay their mortgages in full without prior HUD approval. The deed of trust notes were printed on forms approved by HUD.

The prepayment rules as set forth in the notes reflected contemporaneous HUD regulations governing the Section 221 and Section 236 programs, specifically 24 C.F.R. §§ 221.524(a)(ii) and 236.30(a)(i) (1970).[4] Those regulations also contained language which

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Owners respectively assign, pledge and mortgage to the Commissioner their rights to the rents, profits, income and charges of whatever sort which they might receive or be entitled to receive from the operation of the mortgaged property.... Until a default is declared under this Agreement, however, permission is granted to Owners to collect and retain under the provisions of this Agreement such rents, profits, income, and charges, but upon default this permission is terminated as to all rents due or collected thereafter.

[4] The language in the Section 221 regulations regarding mortgage was essentially the same as that in the Section 236 regulations, which in pertinent part stated:

§ 236.30 Prepayment privileges.

(a) *Prepayment in full--(1) Without prior Commissioner consent.* A mortgage indebtedness maybe prepaid in full and the Commissioner's controls terminated without the prior consent of the Commissioner where....

(ii) [T]he prepayment occurs after the expiration of 20 years from the date of final endorsement of the mortgage....

generally reserved to HUD the right to make future amendments:

> The regulations in this subpart ... may be amended by the Commissioner at any time, and from time to time, in whole or in part, but such amendment will not adversely affect the interests of a mortgagee or lender under the contract of insurance on any mortgage or loan already insured....

24 C.F.R. §§ 221.749 and 236.30 (1970).

By the late 1980s, Congress became concerned that a large number of owners might take advantage of the prepayment clauses within a short period of time, thus drastically reducing the supply of low-income rental housing throughout the country. *See* S.Rep. No. 316, 101st Cong., 2d Sess. 105, *reprinted in* 1990 U.S.Code Cong. & Admin. News 5763, 5867. As a result, Congress enacted two pieces of legislation to directly counter the threat of massive prepayments. The first bill, the Emergency Low Income Housing Preservation Act ("ELIHPA") was enacted in 1987. Pub.L. 100-242, 101 Stat. 1877 (reprinted as amended at 12 U.S.C.A. § 1715*l* (note) (West 1989)). ELIHPA effectively placed a two-year moratorium on prepayments in order to give Congress "breathing room" with which to devise a permanent solution. *Id.* at § 221(b). While it did not prohibit prepayments altogether, ELIHPA did require owners to apply to HUD for permission to prepay. *Id.* at § 222. ELIHPA authorized HUD to approve a prepayment only after making written findings that the prepayment would have minimal effects on the existing tenants, the local low-income housing market in

general, and the local housing market for minorities. *Id.* at § 225.[5]

In 1990, Congress replaced ELIHPA with the Low Income Housing Preservation and Resident Homeownership Act ("LIHPRHA"). In addition to making the moratorium described above permanent, LIHPRHA authorized HUD to provide incentives to owners to maintain the affordability restrictions on their properties.[6] Pub.L. 101-625, 104 Stat. 4249 (reprinted at 12 U.S.C.A. § 4101 *et seq.*. (West 1993)).[7]

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[5] The text of § 225(a), which is specifically applicable to prepayment, reads in part as follows:

> The Secretary may approve a plan of action that involves termination of the low income affordability restrictions only upon a written finding that--
>
> (1) implementation of the plan of action will not materially increase economic hardship for current tenants ... or involuntarily displace current tenants (except for good cause) where comparable and affordable housing is not readily available, determined without regard to the availability of Federal housing assistance that would address any such hardship or involuntary displacement; and
>
> (2)(A) the supply of vacant, comparable housing is sufficient to ensure that such prepayment will not materially affect--
>
> (i) the availability of decent, safe and sanitary housing affordable to lower income and very low-income families or persons in the area that the housing could reasonably be expected to serve;
>
> (ii) the ability of lower income and very low-income families or persons to find affordable, decent, safe, and sanitary housing near employment opportunities; or
>
> (iii) the housing opportunities of minorities in the community within which the housing is located....
>
> These limitations on HUD's discretion to approve prepayments have essentially been preserved at 12 U.S.C. § 4108.

[6] The incentives authorized by LIHPRHA include authorization to increase ceilings on rents, an increase in the authorized annual rate of return from participating properties, financing of capital

Under LIHPRHA, whether a developer wishes to prepay the mortgage or to apply for incentives, the same procedures apply. The process is begun when a property owner files a Notice of Intent ("N.O.I.") with HUD, "in the form and manner" prescribed by the agency, with copies to be sent to state and local housing authorities, mortgagees and tenants. 12 U.S.C. § 4102. The property must then be appraised by two independent appraisers to determine its "preservation value," which in turn becomes a basis for any incentives which are ultimately offered to the owners. 12 U.S.C. § 4103, *see also* §§ 4104(a) and 4110(d). Within nine months after receiving an N.O.I. (or six months if the N.O.I. proposes to terminate affordability restrictions), HUD must send the owner a report containing the results of the appraisals and other information necessary for the owner to proceed. 12 U.S.C. § 4106. The owner must then, within six months, file a Plan of Action ("P.O.A.") with HUD indicating whether the owner wishes to prepay the mortgage (terminating the affordability restrictions), extend the affordability restrictions by requesting incentives, or sell the property to a buyer who will agree to maintain the affordability restrictions. 12 U.S.C. § 4107.

HUD must approve or disapprove a P.O.A. within 180 days of filing, provided the P.O.A. is not deficient. 12 U.S.C. § 4115(b). If a P.O.A. requesting incentives is

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improvements, and equity loans, among other things. 12 U.S.C. § 4109.

[7] LIHPRHA was passed upon the expiration of ELIHPA. Under § 203(a) of ELIHPA, the prepayment restrictions were to expire two years after its enactment, or February 5, 1990. 12 U.S.C. § 1715*l* (note, § 203(a)). ELIHPA's expiration date was extended three times, the last time until November 30, 1990, or the date of the enactment of LIHPRHA, whichever was earlier. Pub.L. No. 101-494 at § 2. Congress eventually passed LIHPRHA on November 28, 1990.

approved after the 180 days have passed, LIHPRHA requires that the incentives be retroactive to 180 days after the filing of the P.O.A. 12 U.S.C. § 4115(c). To ensure the timeliness of HUD's P.O.A. approval process, LIHPRHA allows an owner to seek relief in federal district court if HUD does not approve the P.O.A. within the statutory time limit. *Id.*

The plaintiffs in this case are general or limited partnerships who are owner- participants in the Section 221 or Section 236 programs.[8] The housing projects they own are all located in Culver City, California.

Contentions of the Parties

Plaintiffs contend that by enacting ELIHPA and LIHPRHA, Congress breached a provision of an express contract which plaintiffs had entered into with HUD which would have allowed them to prepay their mortgages after 20 years without HUD approval. Furthermore, plaintiffs argue that by placing severe restrictions on the exercise of their prepayment rights, the government has prevented plaintiffs from putting their properties to more profitable use, effecting either a *per se* or a regulatory taking of private property without just compensation, in violation of the Fifth Amendment's Takings Clause. Finally, plaintiffs contend that HUD has unlawfully delayed implementing those provisions of ELIHPA and LIHPRHA which would provide plaintiffs with financial incentives for maintaining the affordability

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[8] In addition to *Cienega Gardens*, the plaintiffs include the following: Cedar Gardens, Claremont Village Commons, Covina West Apartments, Del Amo Gardens, Del Vista Village, DeSoto Gardens, Independence Park Apartments, Kittridge Gardens I, Kittridge Gardens II, Las Lomas Gardens, Oxford Park, Parthenia Townhomes, Pioneer Gardens, Puente Park Apartments, Rayen Park Apartments, Reseda Park Apartments, Roscoe Park Apartments, St. Andrews Gardens, San Jose Gardens, Sherman Park Apartments, and Sunland Park Apartments

restrictions on their properties. Further, plaintiffs claim that HUD has unlawfully failed to provide for retroactive payment of incentives and unlawfully promulgated appraisal guidelines which result in valuations of their properties at less than fair market value.

Defendant counters that this court lacks jurisdiction to entertain both the contract and taking claims because plaintiffs have not exhausted administrative remedies that could ultimately lead to prepayment. At the same time, defendant contends that all but two plaintiffs lack standing to challenge the prepayment restrictions because they have filed N.O.I.'s or P.O.A.'s with HUD which indicate that they do not intend to prepay their mortgages but rather to seek the financial incentives which are available only to owners who agree to extend the affordability restrictions on their properties. In addition, defendant argues that the contract and taking claims are mooted with respect to the same two plaintiffs, Puente Park and Roscoe Park, because they have already completed binding agreements with HUD to maintain the affordability restrictions.

As for the merits of plaintiffs' contract claim, defendant argues that the claim must fail because plaintiffs have not established privity of contract with HUD in connection with plaintiffs' alleged prepayment rights. Alternatively, defendant contends that plaintiffs contract claims should be barred by the sovereign acts doctrine or its corollary doctrine of "unmistakability." Lastly, defendant argues that even if plaintiffs otherwise establish the existence of an express or implied contract concerning their prepayment rights, relief should be denied on the grounds that HUD or its agents lacked authority to contractually bind the

government to the 20-year prepayment provisions contained in the deed of trust notes.

With regard to plaintiffs' taking claim, defendant contends that plaintiffs have failed to establish that the prepayment restrictions instituted by ELIHPA and LIHPRHA effected a *per se* taking because plaintiffs' putative prepayment rights did not constitute a cognizable property right. Moreover, defendant argues, even if plaintiffs' rights with respect to prepayment can be characterized as "property rights," the prepayment restrictions imposed by ELIHPA and LIHPRHA were a justified exercise of "police power" intended to prevent injury to the public. As for plaintiffs' alternative regulatory taking theory, defendant argues that the court should reject plaintiffs' claim because it does not meet the necessary criteria for a regulatory taking established by case law.

Finally, defendant argues that plaintiffs' third claim, seeking damages for HUD's allegedly unlawful administrative delays and determinations, should be barred on jurisdictional grounds because ELIHPA and LIHPRHA do not mandate monetary damages or retroactive payment of financial benefits for HUD's allegedly unlawful actions. Consequently, defendant argues, plaintiffs have failed to identify a statutory, regulatory or constitutional basis for monetary relief, which is a prerequisite to jurisdiction under the Tucker Act, 28 U.S.C. § 1491.

DISCUSSION

A. Exhaustion of administrative remedies; standing; mootness.

A threshold consideration with regard to plaintiffs' contract and taking claims is defendant's contention that jurisdiction should be denied under "the long settled rule of judicial administration that no one is entitled to judicial relief for a supposed or threatened

injury until the prescribed administrative remedy has been exhausted." *Myers v. Bethlehem Shipbuilding Corp.*, 303 U.S. 41, 50-51, 58 S.Ct. 459, 463, 82 L.Ed. 638, (1938); *Christopher W. v. Portsmouth School Committee*, 877 F.2d 1089, 1093 (1st Cir.1989). Defendant argues that HUD retains limited authority under LIHPRHA to approve a P.O.A. seeking prepayment under 12 U.S.C. § 4114 and, consequently, plaintiffs' case is fatally flawed because plaintiffs have never requested HUD approval for prepayment.

To require administrative exhaustion as a prerequisite to jurisdiction is appropriate in many cases in order to prevent "interference with agency processes, so that the agency may function efficiently and so that it may have an opportunity to correct its own errors, to afford the parties and the courts the benefit of its experience and expertise, and to compile a record which is adequate for judicial review." *Weinberger v. Salfi*, 422 U.S. 749, 765, 95 S.Ct. 2457, 2467, 45 L.Ed.2d 522 (1975); *see also McKart v. United States*, 395 U.S. 185, 194, 89 S.Ct. 1657, 1663, 23 L.Ed.2d 194 (1969). In a case whose facts were nearly identical to the present one, the United States Court of Appeals for the Fourth Circuit ordered that a challenge to the constitutionality of ELIHPA's prepayment restrictions be dismissed on the basis of the exhaustion doctrine. The court observed, "[B]oth the statute and the implementing regulations make clear that, under certain circumstances, HUD has the authority to grant [plaintiffs] the ultimate economic relief they seek--prepayment and withdrawal from the program." *Thetford Properties IV Ltd. Partnership v. HUD*, 907 F.2d 445, 448 (4th Cir.1990).

In reply, plaintiffs argue that LIHPRHA does not authorize HUD to adjudicate the particular claims sought in this case, *i.e.*, breach of contract damages and

just compensation for a taking. Moreover, unlike the plaintiffs in *Thetford Properties*, who had filed N.O.I.'s with HUD seeking prepayment approval, the plaintiffs in the present case are not seeking declaratory or injunctive relief which would allow them to prepay their mortgages. The instant plaintiffs have, in fact, filed N.O.I.'s or P.O.A.'s with HUD seeking whatever preservation incentives LIHPRHA might afford them--not prepayment.

Plaintiffs further contend that to actually seek prepayment via the LIHPRHA administrative process would serve no useful purpose, under the circumstances. In order to be eligible to prepay, plaintiffs argue, an owner must be able to demonstrate, among other things, that prepayment would neither materially increase economic hardships of current tenants nor involuntarily displace them and that prepayment would not materially affect the local supply of housing for minorities or low-income persons. 12 U.S.C. § 4108; 24 C.F.R. § 248.141 (1994). Plaintiffs argue that they cannot sustain such a burden because they cannot truthfully assert that prepayment would have no material effect on either their tenants or the low-income housing market in California. In support of this position, plaintiffs have cited a recent report of the State of California, "Comprehensive Housing Affordability Strategy," which outlines the continuing crisis in the affordable housing market in that state. *See*king prepayment would thus be futile because, lacking evidence that prepayment would not materially affect current tenants or the local housing market, LIHPRHA and HUD's own regulations would require HUD to deny a prepayment application from any of the instant plaintiffs.

At least with respect to plaintiffs's contract claim, it is not necessary to determine whether plaintiff's

prepayment rights amounted to "contract rights" or something less binding on the government (though the court shall analyze that question below) in order to resolve defendant's exhaustion argument. There is no dispute that LIHPRHA negated that language in the deed of trust note which unambiguously permitted plaintiffs to prepay their mortgages in full *without HUD approval* after making payments for 20 years. The "administrative process" to which defendant would have the court bind plaintiffs is not one which would enable plaintiffs to exercise their prepayment rights as stated in their contracts, since under no circumstances may plaintiffs prepay their mortgages without HUD approval. It remains possible under LIHPRHA that HUD will approve a particular prepayment proposal, but such approval may only come after plaintiffs make the significant expenditure of time and money required to prepare and submit an N.O.I. and undergo possibly three separate appraisals. The legislation at issue gave HUD no authority to compensate plaintiffs for these added costs and delays, which would not be incurred had plaintiffs been permitted to simply prepay their mortgages without permission. The court concludes, then, that exhaustion is not required with respect to plaintiffs' contract claim, not because HUD is unlikely to approve prepayment but rather because no administrative procedure exists by which plaintiffs might obtain the relief which they seek, *i.e.*, damages for the alleged loss of an unrestricted prepayment right. *McCarthy v. Madigan*, 503 U.S. 140, 155, 112 S.Ct. 1081, 1092, 117 L.Ed.2d 291 (1992) (exhaustion not required when administrative apparatus could not award remedy sought by plaintiff); *see also Gibson v. Berryhill*, 411 U.S. 564, 575 at n. 14, 93 S.Ct. 1689, 1696 at n. 14, 36 L.Ed.2d 488 (1973). The court, therefore, may exercise its authority under the Tucker Act to adjudicate plaintiffs' contract claim.

When considering a taking claim, the court's concern regarding exhaustion of administrative remedies is more a question of ripeness than jurisdiction. *Williamson Planning Comm'n v. Hamilton Bank of Johnson City*, 473 U.S. 172, 192-93, 105 S.Ct. 3108, 3119-120, 87 L.Ed.2d 126 (1985) (holding that a taking claim is not ripe until the administrative agency has arrived at a final decision); *see also Minority Media of Pahrump, Inc. v. United States*, 27 Fed.Cl. 379, 381-82 (1992). As defendant contends, under LIHPRHA the government retains limited discretion to approve P.O.A.'s proposing prepayment. *See* 12 U.S.C. §§ 4108 and 4114. On the other hand, the court has previously held that exhaustion is not necessary when pursuit of administrative remedies would be futile. *Conant v. United States*, 12 Cl.Ct. 689, 693 (1987). In the present case, if there is a realistic possibility that prepayment would be allowed with regard to a particular plaintiff in this case, administrative exhaustion may indeed be appropriate because it would not be futile. *See Babbitt v. United Farm Workers National Union*, 442 U.S. 289, 298, 99 S.Ct. 2301, 2308-09, 60 L.Ed.2d 895 (1979) ("A plaintiff who challenges a statute must demonstrate a realistic danger of sustaining a direct injury as a result of the statute's operation or enforcement") (citations omitted).

Although the instant plaintiffs insist that HUD would be likely--perhaps even compelled--to disapprove each of their applications for prepayment, should they pursue that option, the evidence in the record supporting their contention is insufficient. Defendant, moreover, disputes plaintiffs' assertion that prepayment disapproval is a foregone conclusion for any or all plaintiffs in this case. The court is reluctant to make findings of fact respecting the prepayment-approval prospects of each of the individual plaintiffs in this case based solely on a

general report of inadequate housing supplies in California. A material factual issue must therefore be resolved, *i.e.*, whether any or all plaintiffs could reasonably expect to be allowed to prepay their mortgages under the current regulatory regime.

Finally, defendant also argues that the majority of plaintiffs lack standing because they have filed P.O.A.'s that seek incentives with HUD but not prepayment, indicating their acquiescence to the prepayment restrictions as enacted. And with respect to two plaintiffs, the Puente Park and Roscoe Park partnerships, defendant argues that those plaintiffs' claims are moot because they have already completed agreements with HUD which explicitly extend the affordability restrictions on their properties over the entire original term of the mortgage, regardless of whether the mortgage remains outstanding.

With respect to plaintiffs' contract claim, the court must reject defendant's argument both as to standing and to mootness. The use agreement makes no explicit reference to plaintiffs' pre-ELIHPA unrestricted prepayment rights, so there is no basis for the court to conclude that by entering such an agreement plaintiffs were waiving any rights and claims they might have had for breach of contract damages based on the legislation. More importantly, HUD, under ELIHPA, has no authority to allow an unapproved prepayment to take place in accordance with the original contract provisions. As for whether defendant's standing or mootness argument should bar plaintiffs' taking claim, the court must defer reaching any conclusion on that issue until the court has been presented with the factual evidence necessary to establish the ripeness of plaintiffs' taking claim, as discussed above.

B. Breach of contract claim.

As discussed above, plaintiffs allege that Congress's enactment of ELIHPA and LIHPRHA effectively breached the contract into which the parties had entered with HUD because ELIHPA and LIHPRHA placed restrictions on mortgage prepayments which would have otherwise been unrestricted after 20 years of payments.

1. Privity of contract.

Defendant's first defense is that HUD has no liability with regard to plaintiff's prepayment rights because there is no privity of contract between HUD and the owners. The prepayment provisions upon which plaintiffs base their claims were contained in the deed of trust notes entered into by plaintiffs and their lenders, not in the regulatory agreement into which HUD entered with the owners. Because HUD was not a party to the deed of trust notes, defendant argues, plaintiffs' putative prepayment rights are not enforceable against the government.

Defendant cites precedents from this court and its predecessor, the United States Court of Claims, which establish the general rule that there is no privity of contract between the United States and housing developers who enter contracts with local housing authorities for the construction of public housing, notwithstanding that local housing agencies who enter such contracts may be doing so under the direct supervision of HUD or that their activities may be financed by HUD. "That the Federal Government has intimate control over a project, including prior approval of plans and costs, does not establish liability...." *Marshall N. Dana Construction, Inc. v. United States*, 229 Ct.Cl. 862, 863, 1982 WL 26554 (1982) (citing *Correlated Development Corp. v. United States*, 214 Ct.Cl. 106, 117-18, 556 F.2d 515, 519 (1977)). *See also*

Housing Corp. of America, 199 Ct.Cl. at 710, 468 F.2d at 924; *National Leased Housing Assn. v. United States*, 32 Fed.Cl. 454, 456-57 (1994).

The court notes that the putative contractual arrangements at issue in *Dana Construction*, Correlated *Development*, *Housing Corp. of America* and *National Leased Housing* did not contain an express written agreement similar to the regulatory agreement into which plaintiffs and the government have entered into in this case, nor did those cases involve an express written agreement analogous to the specific agreement here at issue, *i.e.*, the rider to the deed of trust note allocating prepayment rights between HUD and the plaintiffs. By contrast, in *Dana Construction* and the other cases, the court was faced with a two-tiered contracting system under which, in its first tier, HUD would enter a contract with a local public housing agency to provide federal funding for that agency's low-income housing activities. The local agency, in turn, would distribute that money pursuant to second-tier contracts which the local agency entered directly with housing builders or suppliers. *Dana Construction*, 229 Ct.Cl. at 862, n. 1. *See also Correlated Development*, 214 Ct.Cl. at 108-09, 556 F.2d at 517-19; *Housing Corp. of America*, 199 Ct.Cl. at 708-09, 468 F.2d at 923-24; *National Leased Housing*, 32 Fed.Cl. at 456-57. Although HUD supervised the local agency's activities, the court found no privity between the second-tier contractors and HUD. The present case is distinguishable from *Dana Construction* and related cases because of the absence here of a two-tiered contracting system. Instead, plaintiffs in this case argue, HUD entered directly into an express agreement with the plaintiffs, and the terms of that agreement are embodied in the regulatory agreement and the deed of trust note to which the regulatory agreement refers.

In support of their position, plaintiffs contend that the deed of trust note and the regulatory agreement must be read together in order to find all the terms of the contractual arrangement entered into between plaintiffs and HUD.[9] Plaintiffs point out that essential terms of the regulatory agreement make explicit reference to terms of the deed of trust note, specifically: the obligations imposed by the regulatory agreement were described as being "[i]n consideration of the endorsement for insurance by [HUD]" of the deed of trust note; the regulatory agreement required owners to make all payments due on the deed of trust note in a

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[9] Appendix One of plaintiffs' reply brief in support of its motion for partial summary judgment is a declaration from Alan D. Ross, the attorney who represented Cienega Gardens and some of the other plaintiffs in this case at the original closings in 1970. His written description of the closings include the following:

> For each project in which I was involved, there was a closing which typically took place in the HUD offices in Los Angeles. At each closing, I represented the project owners, the HUD legal counsel represented HUD, and the bank or other lender supplying the mortgage loan had its own counsel or representative present. The contractor, architect, title insurer and corporate surety were also present. At each closing, the parties signed and exchanged the relevant documentation, including the Regulatory Agreement, the Building Loan Agreement, the Note and the Deed of Trust. The lawyer representing HUD presided over each of the closings and approved all of the documentation. Each closing concluded upon endorsement of the Note by an authorized agent of HUD. For each transaction, language was included in the Note affording the project owner a right to prepay the debt evidenced by the Note with the prior approval of the Federal Housing Commissioner, except that after 20 years from final endorsement by HUD, the project owner had an unqualified right to prepay the debt evidenced by the Note without having to obtain the prior approval of the Federal Housing Commissioner. The language setting forth the project owner's prepayment right was supplied by HUD at the request of the Owner.

timely manner (in addition to the identical obligation imposed by the terms of the note itself); the agreement required plaintiffs to set aside cash reserves to minimize the likelihood of a default on the deed of trust note, for which HUD would be liable to the bank under its endorsement of the note; and, most importantly, the regulatory agreement, by its terms, was to remain in effect as long as the deed of trust note remained outstanding, so prepaying the note would have the effect of terminating the regulatory agreement, to which the named parties are the parties in this case.

Plaintiffs also point out that the rider to the deed of trust note which contained the terms of prepayment was logically intended to give rights and obligations to plaintiffs and to HUD. As discussed earlier, the rider gave HUD the right to approve or disapprove prepayment prior to the first twenty years following HUD's endorsement, and the rider allowed prepayment without HUD approval after the first twenty years. Despite the fact that HUD was not a named party to the deed of trust note--the fact upon which defendant's privity argument rests--the rider gave the lender no right whatsoever to interfere with an owner's plan to prepay.[10] The rider gave that power only to HUD, and only permitted such interference during the first 20 years of the mortgage. Because the rider specifically allocated certain rights between HUD and plaintiffs, the fact that HUD was not a named party (except as an endorser) to the deed of trust note containing the rider is not dispositive of the issue of privity of contract between the parties in this action. The government's

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[10] The deed of trust note *did* specify that the lender was entitled to an "adjusted premium charge," according to applicable housing regulations, in the event of prepayment, and the rider required plaintiffs to give the lender 30 days prior written notice of its intent to prepay.

participation as a party to the deed of trust note is unnecessary to establish privity of contract with respect to plaintiff's prepayment rights.[11]

Thus, contrary to defendant's assumptions, the "express contract" upon which plaintiffs base their claim is not to be found solely in either the deed of trust note or the regulatory agreement. The two documents, which were signed contemporaneously, must be read together in order to determine the full intentions of the parties when they initially entered into their relationship. The Restatement of Contracts provides that "all writings that are part of the same transaction are interpreted together." *Restatement (Second) of Contracts*, § 202. *See also Resolution Trust Corp. v. FSLIC*, 25 F.3d 1493, 1499 (10th Cir.1994); *Commander Oil Corp. v. Advance Food Serv. Equip.*, 991 F.2d 49, 53 (2d Cir.1993) ("instruments executed at the same time, by the same parties, for the same purpose and in the course of the same transaction will be read and interpreted together" (quoting *Carvel Corp. v. Diversified Management Group, Inc.*, 930 F.2d 228, 233 (2d Cir.1991)). Applying this guidance to the facts recited above, the court finds that when the parties in this case entered into the regulatory agreement they also intended to be mutually bound by the prepayment rules set forth in the rider to the contemporaneous deed of trust note.

Having thus found privity of contract between the parties in this action, the court also finds, based on the facts now before it, that plaintiffs have established a

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[11] At oral argument plaintiffs' counsel stated that its position was also supported by the court's recent decisions concerning third-party beneficiaries in *Schuerman v. United States*, 30 Fed.Cl. 420 (1994) and *National Sur. Corp. v. United States*, 31 Fed.Cl. 565 (1994). Since the court has not based its conclusion as to the contract claim on a third- party beneficiary theory, discussion of the applicability of those cases is unnecessary.

breach of contract claim, as follows: By signing the regulatory agreement and the deed of trust note to which the regulatory agreement referred, plaintiffs promised to construct and maintain housing in accordance with the HUD's specifications, to accept only low- or moderate- income persons as tenants, to charge no higher rents than those permitted by HUD, to distribute profits to shareholders in accordance with specified limitations, to make timely payments on their mortgages and to maintain cash reserves to self-insure against mortgage default. These promises were made expressly to and for the benefit of the government, not third parties. In exchange, the government agreed to endorse and insure the mortgages (allowing plaintiffs to obtain either subsidized commercial loans or loans at favorable interest rates) and to allow plaintiffs to free themselves of HUD's regulatory strictures after the first 20 years. Accordingly, the court finds that Congress, by enacting ELIHPA and LIHPRHA, breached the government's contracts with plaintiffs with respect to their prepayment rights.

It now remains to be determined whether the government may escape contract liability via the remaining defenses it has raised: the sovereign acts doctrine, the unmistakability doctrine, and lack of contracting authority.

2. Sovereign Acts and unmistakability.

The next defenses which the government has raised in its attempt to defeat plaintiffs' breach of contract claims are the sovereign acts doctrine and its corollary, the so-called "unmistakability" doctrine. "Under [the sovereign acts] doctrine, the government is not contractually liable for acts taken in its sovereign capacity for the public good." *Atlas Corp. v. United States*, 895 F.2d 745, 754 (Fed.Cir. 1990) (holding that the Uranium Mill Tailings Radiation Control Act and its

regulations were sovereign acts undertaken for the public good and could not be a basis for plaintiff's breach of contract claim), *cert denied*, 498 U.S. 811, 111 S.Ct. 46, 112 L.Ed.2d 22 (1990); *Hedstrom Lumber Co. v. United States*, 7 Cl.Ct. 16, 25-29 (1984). The rationale behind this rule has been as follows: "[C]ontractual arrangements, including those to which a sovereign itself is a party, 'remain subject to subsequent legislation' by the sovereign.... [C]ontracts should be construed, if possible, to avoid foreclosing exercise of sovereign authority." *Bowen v. Public Agencies Opposed to Social Security Entrapment*, 477 U.S. 41, 52-53, 106 S.Ct. 2390, 2397, 91 L.Ed.2d 35 (1986) (citation omitted) (hereafter, "POSSE").

POSSE is also frequently cited for the unmistakability doctrine, under which "sovereign power ... will remain intact unless surrendered in unmistakable terms." *Charter FSB v. Office of Thrift Supervision*, 976 F.2d 203, 211 (4th Cir.1992) (quoting *POSSE*), *cert. denied*, 507 U.S. 1004, 113 S.Ct. 1643, 123 L.Ed.2d 265 (1993). It was based on the unmistakability doctrine that the United States Court of Appeals for the Eighth Circuit refused to declare that ELIHPA unconstitutionally denied similarly situated plaintiffs due process of law in *Parkridge Investors Ltd. Partnership v. Farmers Home Administration*, 13 F.3d 1192, 1198 (1994).

In support of its unmistakability argument, defendant argues that because the contemporaneous HUD regulations, 24 C.F.R. §§ 221.749 and 236.30 (1970), quoted above, expressly reserved to HUD the right to amend its regulations in the future, HUD did not "unmistakably" surrender the government's power to alter plaintiffs' putative prepayment rights. As defendant shows, those regulations only provided assurance to mortgage lenders that their contract

rights would be protected in the event of later regulatory change. It provided no similar assurances to mortgage borrowers, such as the instant plaintiffs.

With respect to the sovereign acts doctrine, as plaintiffs maintain, the general rule is that the sovereign acts defense is inapplicable when the "sovereign act" in question is one by which the government has sought to excuse itself from existing contractual liabilities. *See Freedman v. United States*, 162 Ct.Cl. 390, 402, 320 F.2d 359, 366 (1963) ("The doctrine ... does not relieve the government from liability where it has specially undertaken to perform the very act from which it later seeks to be excused"), and the cases cited therein. *See also Everett Plywood Corp. v. United States*, 227 Ct.Cl. 415, 428-29, 651 F.2d 723, 731 (1981) (holding the government liable for unilaterally terminating a contract for the removal of timber after determining that continuing performance would result in severe environmental damage); *Sun Oil Co. v. United States*, 215 Ct.Cl. 716, 768, 572 F.2d 786, 817 (1978) (holding that the doctrine does not insulate the government from liability when the government has taken actions which "were not actions of public and general applicability, but were actions directed principally and primarily at plaintiffs's contractual right" under an oil exploration lease).

In the present case, as in *Sun Oil* and *Everett Plywood*, the court is confronted with government actions undertaken specifically to impede or frustrate the exercise of contractual rights. Moreover, as in *Sun Oil* and *Everett Plywood*, the government cannot be excused from liability merely by invoking a laudatory motivation as the basis for breaching a contract. An act of the government does not qualify as a sovereign act merely because it was undertaken for the public good; the act must also be shown to be generally applicable to

the public, contractors and non-contractors alike. *See also Ottinger v. United States*, 116 Ct.Cl. 282, 285, 88 F.Supp. 881, 882-83 (1950). Here, there is no dispute that the prepayment restrictions contained in ELIHPA and LIHPRHA were enacted specifically to impede property owners' exercise of prepayment rights under contracts entered into by HUD in the Section 221 and Section 236 programs.[12] On that basis, the sovereign acts doctrine is inapplicable in the present case.

The other cases upon which defendant relies are distinguishable from the facts now before the court. In *Atlas*, the court held that the legislation and regulations at issue (concerning the disposal of uranium mill tailing piles) were enacted for public safety reasons and not to modify existing contracts with plaintiffs, despite the added costs which the legislation and regulations imposed upon them. 895 F.2d at 754. In *Hedstrom*, the plaintiffs sued for breach of contract after Congress passed legislation ordering the Secretary of Agriculture to terminate their timber contracts in the Boundary Waters Canoe Area Wilderness ("B.W.C.A.W."). The court opined that the government's explicit breach could be excused on the grounds that the legislation, as a whole, affected "both commercial and recreational" users of the B.W.C.A.W., thus satisfying the "public and general applicability" requirement. Significantly, however, the court decided the case on alternative grounds--a taking theory--since the legislation called for the payment of "just compensation" to parties whose timber contracts were affected by the legislation. *Hedstrom*, 7 Cl.Ct. at 26.

As for the unmistakability doctrine, plaintiffs point out that courts have applied it to block the government's liability only in cases where the

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[12] *See* S.Rep. 101-316 at 105-117, *reprinted in* 1990 U.S.Code Cong. & Admin. News 5763 at 5867-79.

complainant has sought declaratory or injunctive relief from the government's exercise of its sovereign powers. The doctrine provides no defense to a claim for breach of contract damages. *Hughes Communications Galaxy, Inc. v. United States*, 998 F.2d 953 (Fed.Cir.1993); *American Satellite Co. v. United States*, 998 F.2d 950 (Fed.Cir.1993). Thus, defendant's reliance on *Parkridge* to support its unmistakability argument is misplaced. In *Parkridge*, the plaintiffs sought relief, on constitutional grounds, from the implementation of ELIHPA's prepayment restrictions. Unlike the plaintiffs in *Parkridge*, the plaintiffs at bar do not seek to enjoin enforcement of ELIHPA or LIHPRHA's prepayment restrictions, but merely seek monetary compensation for the loss of their substantially unfettered contractual right to prepay. The unmistakability doctrine, therefore, has no application to their case. That result is not changed by the regulatory language of reservation discussed above, from 24 C.F.R. §§ 221.749 and 236.30 (1970) ("The regulations in this subpart ... may be amended by [HUD] at any time, and from time to time, in whole or in part....") since that language merely expresses the truism that the government is always free to change applicable laws. While the regulations cited by defendant also provide express assurances to the primary beneficiaries of HUD mortgage insurance--*i.e.*, mortgage lenders--in the event of regulatory amendments, those rules do not disclaim any potential contract liability *vis-a-vis* mortgagors.

3. Lack of authority.

Defendant's final argument with respect to plaintiffs' contract claim is that even if HUD intended to promise plaintiffs that they could repay their mortgages regardless of future legislation restricting them from doing so, this promise would be

unenforceable for lack of express authority from Congress. In support of this argument, defendant has cited *Federal Crop Insurance Corp. v. Merrill*, 332 U.S. 380, 68 S.Ct. 1, 92 L.Ed. 10 (1947); *Office of Personnel Management v. Richmond*, 496 U.S. 414, 110 S.Ct. 2465, 110 L.Ed.2d 387 (1990); and *Transohio Sav. Bank v. Director*, Office of Thrift Supervision, 967 F.2d 598 (D.C.Cir.1992). The court has examined each of these authorities and found them to be inapplicable to the present case, for the reasons discussed below. Finding no other persuasive authority to support defendant's position concerning HUD's lack of contracting authority, the court concludes it is without merit.

Federal Crop Insurance stands for the proposition that one who deals with a government agent bears the burden of determining that the agent is authorized to bind the government. 332 U.S. at 384, 68 S.Ct. at 3. The court does not now dispute this principle, but finds it inapposite to the present case because there is no information in the record suggesting that the HUD agents who entered agreements concerning the 20-year prepayment rule were not authorized to do so. As discussed earlier, contemporaneous HUD regulations at 24 C.F.R. §§ 221.749 and 236.30 (1970) expressly permitted a 20-year prepayment rule as described in the riders to plaintiffs' deed of trust notes. Moreover, while it does not appear that HUD was ever required by statute to permit mortgagors to prepay after 20 years, the legislation enacting the Section 221 and Section 236 programs nonetheless gave HUD broad discretion "to make such rules and regulations, to enter into such agreements, and to adopt such procedures as [it] may deem necessary or desirable to carry out the provisions of [Section 236]." 82 Stat. at 499-500; *see also* 68 Stat. 600-01 (concerning Section 221). In giving HUD such discretion, therefore, Congress authorized the 20-year prepayment rule at issue in this case.

Richmond, on the other hand, conveys the general rule that a person claiming entitlement to a government benefit cannot use erroneous or unauthorized information given by a government employee to estop the government from disputing the entitlement. 496 U.S. at 430-34, 110 S.Ct. at 2474-76. *Richmond* is inapplicable simply because plaintiffs are not relying on an estoppel theory to advance their cause.

The third case which defendant cites, *Transohio*, is a nonbinding precedent which states that "An agency . . . cannot contract away Congress's sovereign power to regulate unless Congress has clearly and unmistakably empowered the agency to do so." 967 F.2d at 622. To the extent that the D.C. Circuit meant that an agency could not, by regulation, preempt the effect of future legislation, this court does not disagree; the principle is essentially the same one enunciated by the Supreme Court in *POSSE*. As with *POSSE* and *Parkridge*, however, the plaintiffs in *Transohio* were seeking injunctive relief from the application of statutes which frustrated an agreement into which plaintiffs had previously entered with a government agency. As discussed above, the plaintiffs at bar seek breach of contract damages, not injunctive relief, and on that basis *Transohio* is inapplicable.

Although the court has found a contractual breach, the factual record now before the court contains no evidence on which the court could assess damages. For that reason, trial is necessary with regard to the contract claim for the purpose of determining damages.

C. Taking claim.

The Takings Clause of the Fifth Amendment guarantees that private property shall not be taken for public use without just compensation. This provision was "designed to bar [the] Government from forcing some people alone to bear the public burdens which, in

all fairness and justice, should be borne by the public as a whole." *Armstrong v. United States*, 364 U.S. 40, 49, 80 S.Ct. 1563, 1569, 4 L.Ed.2d 1554 (1960). In support of their taking claim, plaintiffs argue that they have suffered either a *per se* taking of their property or, alternatively, a regulatory taking without just compensation. Both theories are based on the fact that ELIHPA and later LIHPRHA took away plaintiffs' previously unfettered right to prepay their mortgages and withdraw their properties from the federal housing programs.

1. Prepayment as a property right.

Before proceeding with a detailed analysis of plaintiffs' alternative taking claims--and assuming that plaintiffs prove their cause is ripe for adjudication at trial--the court must next determine whether the prepayment restrictions which aggrieve plaintiffs affect a "property right." Since the court has already found that plaintiffs' right to prepay their mortgages was a contractual right, and since that contractual right directly concerned plaintiffs' interests in their property, it is logical also to find that when the government imposed restrictions on plaintiffs' ability to prepay their mortgages and to liberate their properties from federal regulations connected to their mortgages, those restrictions affected a "property right." "In the bundle of rights we call property, one of the most valued is the right to sole and exclusive possession--the right to *exclude* strangers, or for that matter friends, but especially the Government." *Hendler v. United States*, 952 F.2d 1364, 1374 (Fed.Cir.1991) (emphasis in original) (citations omitted).

Hendler makes clear that the property right of "exclusive possession" can be implicated both in the context of a *per se* taking and in the context of a regulatory taking. *Id.* at 1374-75. In the present case,

plaintiffs' exclusive possessory interest in their property has been implicated by the continuing presence of low-income tenants, and that is the basis of plaintiffs' *per se* taking claim.

Again assuming that plaintiffs establish ripeness at trial, the prepayment restrictions also appear to interfere with plaintiffs' exclusive possessory rights in a regulatory taking sense. If, as applied, the prepayment restrictions compel any plaintiff to extend the regulatory agreement beyond the first 20 years of the mortgage (*i.e.*, longer than plaintiffs could have expected under the terms of their agreement with the government), then that plaintiff has been denied exclusive possession of his property because HUD has retained a substantial, controlling interest in the property, by virtue of the regulatory agreement. As discussed earlier, the regulatory agreement severely limits the uses to which a plaintiff may put his property. The court thus finds that plaintiffs have identified a property right sufficient for analysis in the regulatory taking context; as discussed later, it remains to be seen whether the government's regulatory imposition on plaintiffs' property is of the type which, under applicable case law, requires compensation.

2. Per se taking.

In characterizing their injury as a *per se* taking, plaintiffs argue that the continued tenancy by government-approved persons, on government-approved terms, constitutes the kind of "permanent, physical occupation" which is tantamount to a physical, or *per se*, taking of their property. *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 434-35, 102 S.Ct. 3164, 3175, 73 L.Ed.2d 868 (1982). If a plaintiff can establish that government action is a *per se* taking, there is no need to balance the public benefit of the government action against the private burden

borne by the plaintiff, since a *per se* taking interferes with the owner's fundamental possessory rights with respect to the property. *Loretto*, 458 U.S. at 434-35, 102 S.Ct. at 3175 (a *per se* taking "occurs without regard to whether the action achieves an important public benefit or has only minimal economic impact on the owner"); *Hendler*, 952 F.2d at 1374.

In light of the authorities cited by plaintiffs, however, their contention that the continued presence of low-income tenants on their properties constitutes a "permanent, physical occupation" is unpersuasive. In both *Loretto* and *Hendler* the alleged "physical occupation" resulted directly from a physical invasion of the plaintiffs' property, either at the behest of the government (in *Loretto*) or by government officials (in *Hendler*).[13] In both cases, property owners were prohibited from interfering with the invasion and from disturbing equipment which the invaders had left behind on the plaintiffs' property. In both cases, the court found a resulting *per se* taking for which the Constitution mandated just compensation, notwithstanding the degree of actual damage.

The facts in the instant case are sufficiently distinguishable from those in *Loretto* and *Hendler*, such that the court must view those cases as inapposite. In the present case plaintiffs have not demonstrated any physical invasion analogous to the undisputed invasions which occurred in *Loretto* and *Hendler*. Instead,

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[13] The Supreme Court has made clear that, in the *per se* taking context, it is irrelevant that the act of "taking" at issue be done by the government "or instead by a party authorized by the [government]." *Loretto*, 458 U.S. at 432, n. 9, 102 S.Ct. at 3174, n. 9; *see also Kaiser Aetna v. United States*, 444 U.S. 164, 179-80, 100 S.Ct. 383, 392- 93, 62 L.Ed.2d 332 (1979); *Nollan v. California Coastal Comm'n*, 483 U.S. 825, 831-32, 107 S.Ct. 3141, 3145, 97 L.Ed.2d 677 (1987); *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1015-16, 112 S.Ct. 2886, 2893, 120 L.Ed.2d 798 (1992).

plaintiffs have complained only of the "continued presence" of low-income tenants past the date on which plaintiffs, exercising their prepayment rights, ought to have been able to evict low-income tenants, either by increasing rents above HUD-mandated ceilings or by converting their apartments to some other more lucrative use.

Plaintiffs' taking th(ory is substantively similar to the one espoused by the appellants in *Hall v. City of Santa Barbara*, 833 F.2d 1270 (9th Cir.1987), *cert. denied*, 485 U.S. 940, 108 S.Ct. 1120, 99 L.Ed.2d 281 (1988). In that case the appellants, owners of mobile home parks, claimed that a local ordinance imposing rent controls on mobile home pads transferred a perpetual, possessory interest in the property from landlord to tenant while allowing only below-market rents. 833 F.2d at 1276. The offending ordinance required the owners of the parks to offer tenants leases of unlimited duration, which could be terminated at will by the tenant but only for cause by the landlord. *Id.* at 1273. In practice, the ordinance allowed a tenant to transfer his right to use the pad at the regulated rental rates to a future tenant when selling the mobile home as installed on the pad, a practice which the landlord could do little to prevent. *Id.* at 1276-77. The Ninth Circuit concluded that the ordinance authorized a permanent, physical occupation of the landlord's property because it deprived the landlord of any meaningful power to exclude others and because it prohibited the landlord from making any "nonpossessory use of the property." *Id.* at 1277. Consequently the court held the ordinance to be an

unconstitutional taking without just compensation, in violation of the Fourteenth Amendment.[14]

The Supreme Court explicitly overruled *Hall* in a later case, *Yee v. City of Escondido*, 503 U.S. 519, 112 S.Ct. 1522, 118 L.Ed.2d 153 (1992). In *Yee*, the Court was faced with a city rent control ordinance which was similar to the one at issue in *Hall*. The petitioners in *Yee* argued that the rent control ordinance--viewed against the backdrop of California's Mobilehome Residency Law, which limited the ability of the owner of a mobile home pad to interfere with the sale of the mobile home in place upon the pad--effected a permanent physical occupation of their property. 503 U.S. at 521-24, 112 S.Ct. at 1526. The combined effect of the two laws, the petitioners argued, was to require the mobile home park owners to rent their pads to strangers--in other words, a state-authorized deprivation of the petitioners' "right to exclude," which is protected by the Fifth and Fourteenth Amendments.[15] *Kaiser Aetna v. United States*, 444 U.S. 164, 176, 100 S.Ct. 383, 391, 62 L.Ed.2d 332 (1979). The Court held that the ordinance was not a taking, finding that neither the ordinance nor the Mobilehome Residency Law compelled petitioners to rent their property. In fact, the court noted, the Mobilehome Residency Law allowed owners to evict their tenants with either six or 12 months notice. *Yee*, 503 U.S. at 526-28, 112 S.Ct. at 1528.

Notwithstanding the Court's finding that mobile home park owners had not suffered a permanent,

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[14] The Fifth Amendment's Takings Clause applies to the states via the Fourteenth Amendment. *Chicago, B. & Q. R. Co. v. Chicago*, 166 U.S. 226, 17 S.Ct. 581, 41 L.Ed. 979 (1897).

[15] Only the local ordinance, and not California's Mobilehome Residency Law, was challenged in *Yee*, 505 U.S. at 531 n. 1, 112 S.Ct. at 1530, n. 1.

physical occupation in *Yee*, plaintiffs in the case at bar now call the court's attention to a *dictum* in Justice O'Connor's majority opinion in which the Court suggested that "[a] different case would be presented were the statute, on its face or applied, to compel a landowner over objection to rent his property or to refrain in perpetuity from terminating a tenancy." *Yee*, 503 U.S. at 528, 112 S.Ct. at 1529 (citations omitted). Plaintiffs argue that their situation presents just such a case.

Plaintiffs have also drawn an analogy between the *dictum* in *Yee and Seawall Associates v. City of New York*, 74 N.Y.2d 92, 544 N.Y.S.2d 542, 542 N.E.2d 1059 (1989), *cert. denied*, 493 U.S. 976, 110 S.Ct. 500, 107 L.Ed.2d 503 (1989). In *Seawall*, the New York Court of Appeals examined a New York City ordinance enacted to prevent the destruction, conversion or neglect of single-room occupancy buildings ("S.R.O.'s"), and the court found the ordinance to be a *per se* taking. Intended as a measure to prevent homelessness, the New York City ordinance placed a moratorium on the "conversion, alteration or demolition" of S.R.O. buildings. The ordinance further required owners to "rehabilitate and make habitable" every S.R.O. unit and to lease each unit to a bona fide tenant (the court referred to the latter requirement as a "rent-up" obligation). Stiff penalties were to be assessed in the event that an owner illegally demolished an S.R.O. building, converted it to non-S.R.O. use, or allowed an individual unit in an S.R.O. building to remain vacant for more than 30 days. 74 N.Y.2d at 100-01, 544 N.Y.S.2d at 544, 542 N.E.2d at 1061. Owners could escape these penalties only by paying the New York City housing commissioner a fee which represented the cost of replacing the S.R.O. units lost by the conversion or demolition; the fee could be reduced somewhat, at the commissioner's discretion, upon a showing by the

owner that preservation of an S.R.O. unit could not be achieved with a reasonable rate of return to the owner. 74 N.Y.2d at 101, 544 N.Y.S.2d at 544-45, 542 N.E.2d at 1061-62.

The New York Court of Appeals agreed with Seawall Associates that the ordinance's requirements that they rehabilitate and "rent-up" their buildings and not convert them to more profitable use constituted a *per se* taking. As the court observed:

> [The ordinance] requires the owners to rent their rooms or be subject to severe penalties; it compels them to admit persons as tenants with all of the possessory and other rights that that status entails; it compels them to surrender the most basic attributes of private property, the rights of possession and exclusion.

Seawall, 74 N.Y.2d at 102, 544 N.Y.S.2d at 546, 542 N.E.2d at 1063, *citing Loretto*, 458 U.S. at 435, 102 S.Ct. at 3175-76; *Kaiser Aetna*, 444 U.S. at 179-80, 100 S.Ct. at 392-93. Plaintiffs in the present action analogize their cause to the plight facing the plaintiffs in *Seawall*, arguing that because ELIHPA and LIHPRHA make it impossible for them to prepay their mortgages and escape their regulatory agreements without HUD approval, they are forced to maintain their properties as low-income housing and, thus, forced "to rent their properties to strangers." *Seawall*, 74 N.Y.2d at 105, 544 N.Y.S.2d at 547, 542 N.E.2d at 1064.

Precedents of the New York Court of Appeals, of course, are not binding on the Court of Federal Claims. At the same time, however, this court cannot ignore the New York court's vast experience with landlord-tenant law. Accordingly, the court finds instructive the careful distinctions drawn in the court's opinion between the *Seawall* case and those cases in which either the New York Court of Appeals or the Supreme Court has

upheld--against challenge on takings grounds--"the government's power to adjust landlord-tenant relationships." *Id.*

The *Seawall* court observed that the typical rent control and landlord- tenant regulations which it and the Supreme Court had upheld "merely involved restrictions imposed on *existing* tenancies where the landlords had voluntarily put their properties to use for residential housing. Unlike [the New York City ordinance] however, those regulations did not force owners . . . to subject their properties to a use which they neither planned nor desired." *Seawall*, 74 N.Y.2d at 105, 544 N.Y.S.2d at 547-48, 542 N.E.2d at 1064-65 (emphasis added) For example, the court noted that in *Loab Estates, Inc. v. Druhe*, 300 N.Y. 176, 179, 90 N.E.2d 25 (1949), the ordinance in question prohibited the eviction of tenants unless provisions had been made for their relocation. And in *Bowles v. Willingham*, 321 U.S. 503, 517, 64 S.Ct. 641, 648, 88 L.Ed. 892 (1944), the Supreme Court upheld a federal rent control statute against a taking challenge because the statute did not force an owner to offer his or her property as rental accommodations. The *Seawall* court observed, "By sharp contrast to the statutes in *Loab Estates* and *Bowles*, [the S.R.O. ordinance] compell[ed] owners to be residential landlords [and required them to] rehabilitate and offer their properties for rent, as S.R.O. units, to persons with whom they have no *existing* landlord-tenant relationship." 74 N.Y.2d at 106, 544 N.Y.S.2d at 548, 542 N.E.2d at 1065 (emphasis added).

The essential distinction drawn by the *Seawall* court between the regulation of existing landlord-tenant relationships and a requirement, such as the one imposed by the New York City ordinance, that a landlord rehabilitate and "rent-up" vacant property against his will, is applicable to plaintiffs' claim for a *per*

se taking in the case at bar. The prepayment restrictions under ELIHPA and LIHPRHA have the effect of providing existing tenants with added protections against losing their homes than they presumably had when owners had an unfettered right to prepay their mortgages. Furthermore, unlike the "rent-up" obligations imposed by the local ordinance at issue in *Seawall*, the prepayment restrictions imposed by ELIHPA and LIHPRHA cannot fairly be characterized as forcing landlords to accept unwelcome tenants on previously vacant properties. Plaintiffs in the present case entered the landlord business voluntarily, more than 20 years ago, and low-income tenants--the "strangers" whose presence now offends their sense of justice--have been occupying their properties since they were built. Consequently, the court must find ELIHPA and LIHPRHA to be more analogous to the rent control ordinances upheld in such cases as *Yee* than to the S.R.O. ordinance struck down by *Seawall*.

It should also be noted that the plaintiffs in the *Seawall* case were situated somewhat differently from the plaintiffs in the present case. The *Seawall* plaintiffs were real estate developers who had purchased S.R.O. buildings with the specific intent of demolishing them or converting them to higher uses. Many of the plaintiffs had apparently acquired their properties before 1985, when the first version of the demolition moratorium was imposed. Before 1982, New York City actually granted tax abatements to *encourage* the demolition or redevelopment of S.R.O.'s, which were then considered substandard housing. The city underwent a change of heart, however, when confronted with a rising homeless population during the early-to-mid 1980's; the city council attributed the rising homelessness at least in part to the loss of S.R.O. units. 74 N.Y.2d at 99-100, 544 N.Y.S.2d at 544, 542

N.E.2d at 1061; *see also* 74 N.Y.2d at 119-20, 544 N.Y.S.2d at 556-57, 542 N.E.2d at 1073-74 (Bellacosa, J., dissenting). Thus, unlike the plaintiffs in the case at bar, the *Seawall* plaintiffs did not purchase their properties primarily to earn rents from S.R.O. tenants, but rather to see those tenancies through to termination so that the units could demolished or converted to non-S.R.O. purposes. As the New York court explained, above, the city ordinance forced S.R.O. owners into the role of landlord on a permanent basis. The prepayment restrictions of ELIHPA and LIHPRHA, however, do no such thing, since the plaintiffs at bar entered the landlord business deliberately and long ago.

The court finds, therefore, that the case at bar is not the type to which the Supreme Court referred in its *Yee dictum* because the prepayment restrictions do not, on their face or as applied, "compel a landowner over objection to rent his property or to refrain in perpetuity from terminating a tenancy." *Yee*, 503 U.S. at 531, 112 S.Ct. at 1529. As *Yee* made clear, a landlord-tenant regulation may transfer some degree of interest from the landlord to the tenant without such a transfer rising to the level of a "permanent, physical occupation," just as it does in the rent control context. Since the effect of the prepayment restrictions in the present case is merely to enhance an existing tenant's possessory interest, the court must conclude that the prepayment restrictions do not rise to the level of authorizing a "permanent, physical occupation" within the meaning of *Seawall*, *Loretto* or *Hendler*. Consequently, plaintiffs have failed to show that they have suffered a *per se* taking within the meaning of the Fifth Amendment.

3. Regulatory taking.

Plaintiffs argue, in the alternative, that even if the prepayment restrictions do not amount to a *per se*

taking, then the court should view them as a regulatory taking. A taking by regulation (or, as appropriate, legislation) may occur if the government, by placing burdens on property owners, goes "too far" in interfering with rights incident to property ownership. *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415, 43 S.Ct. 158, 160, 67 L.Ed. 322 (1922).

Plaintiffs have correctly identified the basic elements which must be considered when determining whether a regulation goes "too far": (1) the character of the governmental action, (2) the economic impact of the government's action, and (3) the extent to which the government's action interferes with plaintiffs' distinct investment-backed expectations. *Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 124, 98 S.Ct. 2646, 2659, 57 L.Ed.2d 631 (1978).

The courts have provided ample guidance for applying the three *Penn Central* factors in other cases. The first factor--the character of the governmental action--is a requirement that the alleged regulatory imposition be one which seriously interferes with a property right, but which is not otherwise authorized by constitutional or common law. Accordingly, actions which can be characterized as an exercise of "police power" have been distinguished from takings under the Fifth Amendment, not because such actions do not restrict the use of property but rather because its unrestricted use would be injurious to the public. *Allied-General Nuclear Services v. United States*, 839 F.2d 1572, 1576 (Fed.Cir.1988) (citation omitted), *cert. denied*, 488 U.S. 819, 109 S.Ct. 61, 102 L.Ed.2d 39 (1988); *see also Penn Central*, 438 U.S. at 125, 98 S.Ct. at 2659-60 and *B & F Trawlers, Inc. v. United States*, 27 Fed.Cl. 299, 304-05 (1992) (citations omitted). Similarly, the Fifth Amendment has been held not to limit the exercise of the government's power to abate a nuisance.

Lucas v. South Carolina Coastal Council, 505 U.S. 1003, 112 S.Ct. 2886, 120 L.Ed.2d 798 (1992); *see also Loveladies Harbor, Inc. v. United States*, 28 F.3d 1171, 1178-79 (Fed.Cir.1994). And a local government's power to enact zoning regulations has usually withstood a Takings Clause challenge, even when such regulations prohibit the most profitable use of private property. *Euclid v. Ambler Realty Co.*, 272 U.S. 365, 47 S.Ct. 114, 71 L.Ed. 303 (1926) (upholding a zoning ordinance barring industrial use); *Gorieb v. Fox*, 274 U.S. 603, 608, 47 S.Ct. 675, 677, 71 L.Ed. 1228 (1927) (upholding a requirement that portions of land parcels be left unbuilt); *Welch v. Swasey*, 214 U.S. 91, 29 S.Ct. 567, 53 L.Ed. 923 (1909) (upholding height restrictions); *see also Florida Rock Indus. Inc. v. United States*, 791 F.2d 893, 901 (Fed.Cir.1986) ("The regulation may allowably have some adverse effect on the market value, as of course is almost inevitable if the most profitable use is prohibited."), *cert. denied*, 479 U.S. 1053, 107 S.Ct. 926, 93 L.Ed.2d 978 (1987) (citations omitted) (hereafter "*Florida Rock I*").

The second *Penn Central* factor, the economic impact of the regulation on the claimant, has been restated as "a threshold requirement that the plaintiff show a serious financial loss from the regulatory imposition," to the extent that the plaintiff has been denied "economically viable use" of his or her property. *Loveladies Harbor*, 28 F.3d at 1177; *see also Lucas*, 505 U.S. at 1015-16, 112 S.Ct. at 2893; *Agins v. Tiburon*, 447 U.S. 255, 260, 100 S.Ct. 2138, 2141, 65 L.Ed.2d 106 (1980); *Nollan*, 483 U.S. at 834, 107 S.Ct. at 3147. The Federal Circuit, whose precedents are binding on this court, has also rejected the view that the "loss of economically viable use" criterion requires a plaintiff, in a regulatory taking case, to show that he or she has suffered a total loss of economic value in the property at issue. *Loveladies Harbor, Inc. v. United States*, 28 F.3d

at 1180-81; *see also Florida Rock Indus. Inc. v. United States*, 18 F.3d 1560, 1567-71 (Fed.Cir.1994), *cert. denied*, 513 U.S. 1109, 115 S.Ct. 898, 130 L.Ed.2d 783 (1995) (hereafter "*Florida Rock II*"). In this regard, the Federal Circuit has held that it is necessary and relevant for the court to consider whether the government, in imposing a regulation on a property owner, "acted fairly and reasonably, so that private parties can pursue their interests." *Florida Rock II*, 18 F.3d at 1571. The Federal Circuit further instructed:

> [W]hen the Government acts as the intermediary between private interests to provide a mutually beneficial environment from which all benefit and in which all can thrive, the shared diminution of free choice that results may not rise to the level of constitutionally required compensation.
>
> In addition, then, to a demonstration of loss of economic use to the property owner as a result of the regulatory imposition ... the trial court must consider: are there direct compensating benefits accruing to the property, and others similarly situated, flowing from the regulatory environment? Or are benefits, if any, general and widely shared through the community and the society, while the costs are focused on a few? Are alternative permitted activities economically realistic in light of the setting and circumstances, and are they realistically available? In short, has the Government acted in a responsible way, limiting the constraints on property ownership to those necessary to achieve the public purpose, and not allocating to some number of individuals, less than all, a burden that should be borne by all?

Florida Rock II, 18 F.3d at 1571.

With regard to the third factor--the extent to which the regulation interferes with distinct investment-backed expectations, the Supreme Court has concluded that, to enjoy the protection of the Fifth Amendment, investment- backed expectations must be reasonable. *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1005, 104 S.Ct. 2862, 2874, 81 L.Ed.2d 815 (1984). As applied in *Monsanto*, the reasonableness limitation meant that a plaintiff's claim may not be based on an expectation that a government agency will, in its particular case, fail to comply with applicable statutes and regulations. *See also Golden Pacific Bancorp v. United States*, 15 F.3d 1066, 1074 (Fed.Cir.1994); *American Continental Corp. v. United States*, 22 Cl.Ct. 692, 696 (1991).

Although both parties have invoked the appropriate *Penn Central* test for a regulatory taking, neither plaintiffs nor defendant has briefed the court on the facts or the reasoning upon which Justice Brennan based his majority opinion; in applying the *Penn Central* test to the controversy now before the court, however, it is helpful to revisit that opinion in detail.

In *Penn Central*, the court was faced with a challenge to the New York City Landmarks Preservation Law, under which Grand Central Terminal in midtown Manhattan was designated an historic landmark worthy of preservation for its historic and cultural value. As the court observed:

> The New York City law is typical of many urban landmark laws in that its primary method of achieving its goals is not by acquisitions of historic properties, but rather by involving public entities in land-use decisions affecting these properties and providing services, standards, controls, and incentives that will encourage preservation by private owners and

> users. While the law does place special restrictions on landmark properties as a necessary feature to the attainment of its larger objectives, the major theme of the law is to ensure the owners of any such properties both a "reasonable return" on their investments and maximum latitude to use their parcels for purposes not inconsistent with the preservation goals.

438 U.S. at 109-10, 98 S.Ct. at 2652 (footnotes omitted). The owners of Grand Central Terminal challenged the preservation law under the Takings Clause after municipal authorities refused to grant them a permit to construct a 53-story skyscraper in the space above the station. *Id.* at 117- 19, 98 S.Ct. at 2655-57.

The court rejected the appellants' basic theory, finding that "the submission that appellants may establish a 'taking' simply by showing that they have been denied the ability to exploit a property interest that they heretofore had believed was available for development is quite simply untenable." *Id.* at 130, 98 S.Ct. at 2662. Instead, the court used the tripartite analysis discussed above.

With regard to the character of the regulation--the first *Penn Central* factor--the court disagreed with appellant's efforts to distinguish the landmarks preservation law from (among other things) zoning ordinances. Appellants argued that unlike zoning ordinances, which affected property owners within whole geographic areas, the landmark preservation law targeted selected buildings for special treatment. The court found the distinction unpersuasive. As the court reasoned, "Legislation designed to promote the general welfare commonly burdens some more than others.... [Z]oning laws often affect some property owners more severely than others but have not been held to be

invalid on that account. For example, the property owner in *Euclid* who wished to use its property for industrial purposes was affected far more severely by the ordinance than its neighbors who wished to use their land for residences." *Id.* at 133-34, 98 S.Ct. at 2664.

In the present case, the record before the court with respect to the character of the government action does not weigh sufficiently in plaintiffs' favor to sustain a motion for summary judgment. It is undisputed, of course, that the prepayment restrictions imposed by ELIHPA and LIHPRHA substantially interfered with plaintiffs' ability to exercise whatever prepayment rights they might have had under their original deed of trust notes. And both parties also agree that the critical advantage that plaintiffs could obtain by prepaying their mortgages was that they would be able to charge market-rate rents or convert their properties to even more profitable uses--in other words, prepayment would allow plaintiffs to terminate their regulatory agreements and use their properties for purposes other than low-income housing. Furthermore, it is undisputed that Congress's avowed intention in restricting prepayment rights was to preserve existing low-income housing for its original purpose. As such, however, the prepayment restrictions appear to bear a striking resemblance to the New York City landmarks preservation law at issue in *Penn Central*. Like the landmarks preservation law, the prepayment restrictions in the present case are a regulatory imposition which encourage the preservation of the existing use of plaintiffs' property as low-income housing. Of course, it is not within the province of the court to weigh the relative societal merits between preservation of historic landmarks and preservation of the low-income housing market; that is the prerogative of the legislature. But to the extent that plaintiffs

might distinguish landmark preservation from housing preservation on the grounds that the latter transfers some benefits to tenants at the expense of landlords--on top of the general social benefit of providing for adequate housing--such reasoning, as discussed above, was rejected by the Supreme Court as a ground for finding a taking in *Yee*.[16] Because of these factual consistencies between this case and *Penn Central* and *Yee*, therefore, the court is not yet convinced that the government, by enacting the prepayment restrictions, has exceeded the limits of what is permissible under the Fifth Amendment without just compensation.

Inasmuch as plaintiffs' case with regard to the first *Penn Central* criterion is weak at this stage, defendant's theory that the prepayment restrictions represent an exercise of the government's "police power" is even more attenuated. Defendant argues that Congress enacted the prepayment restrictions in order to avert a national crisis in the supply of low-income housing, and, on that ground, the government is not liable for compensation under the Takings Clause even if the restrictions are found to abrogate a "property right."

As discussed above, courts have long held government actions to be immune from a Takings Clause challenge when such actions are undertaken to protect the public health, safety or morals (or, alternatively, the public welfare). Accordingly, courts have accepted the police power defense for actions which resulted in the seizure or destruction of private property without compensation when such actions were undertaken, for example, to prevent the manufacture or

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[16] The court notes that in its *Yee* decision, the Supreme Court discussed, but did not decide, whether the Escondido rent control ordinance was a regulatory taking. 503 U.S. at 532-39, 112 S.Ct. at 1531-34.

sale of alcoholic beverages (*Mugler v. Kansas*, 123 U.S. 623, 666, 8 S.Ct. 273, 299, 31 L.Ed. 205 (1887)); to prevent the spread of disease (*Miller v. Schoene*, 276 U.S. 272, 279-80, 48 S.Ct. 246, 247-48, 72 L.Ed. 568 (1928)); to prevent the spread of a conflagration (*B & F Trawlers*, 27 Fed.Cl. at 304-05), or to prevent nuclear proliferation (*Allied-General*, 839 F.2d at 1576). The police power defense has also succeeded where the government has prohibited a particular use of private property which would be injurious to the public (but not seized or destroyed property) as in *Jarboe-Lackey Feedlots, Inc. v. United States*, 7 Cl.Ct. 329, 338-39 (1985).

The government's reliance on the police power defense as justifying the action at issue in this case, however, is misplaced. By comparison with the precedents, the mere declaration by Congress or a government agency that a "housing crisis" exists would not appear to establish a *prima facie* case that the public's health, safety, morals or welfare are endangered to a point which would justify an abrogation of any or all of plaintiffs' property rights. To the contrary, a housing shortage appears to be precisely the kind of societal problem which calls for an inquiry into whether the restrictions on private property enacted to combat the problem "force some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." *Armstrong*, 364 U.S. at 49, 80 S.Ct. at 1569. It calls, in other words, for analysis as a taking and not as an exercise of police power.

With regard to the second *Penn Central* factor, *i.e.*, the economic impact of the regulatory imposition, the Supreme Court observed that the designation of Grand Central Terminal as a historic landmark "not only permits but contemplates that appellants may continue

to use the property precisely as it has been used for the past 65 years.... So the law does not interfere with what must be regarded as Penn Central's primary expectation concerning the use of the parcel." 438 U.S. at 136, 98 S.Ct. at 2665. The Court further found that the continued use as a railroad terminal permitted Penn Central to earn a " 'reasonable return' on its investment," even though the landmark designation prohibited the most profitable use of the station. *Id.* The essential part of the "most profitable use" thwarted by regulation was appellant's full exploitation of its air rights above the station. The Court observed, however, that in addition to the landmark development restrictions, New York City had also implemented a program whereby a developer such as Penn Central could sell or transfer its lost development rights to other properties in the same neighborhood. The Court found that such transfer rights lessened the economic impact of the restrictions inherent in the landmark designation:

> While [transfer] rights may well not have constituted "just compensation" if a "taking" had occurred, the rights nevertheless undoubtedly mitigate whatever financial burdens the law has imposed on applicants and, for that reason, are to be taken into account in considering the impact of regulation.

438 U.S. at 137, 98 S.Ct. at 2666 (citation omitted). On the other hand, the Federal Circuit has clarified that "the mere presence" of financial benefits in a regulatory scheme which is otherwise alleged to constitute a taking does not necessarily dispose of the issue of whether a taking has occurred. *Whitney Benefits, Inc. v. United States*, 752 F.2d 1554, 1557 (Fed.Cir.1985), *cert. denied*, 502 U.S. 952, 112 S.Ct. 406, 116 L.Ed.2d 354 (1991) (holding that the inclusion of a formula for

determining just compensation in legislation restricting surface mining rights does not preclude court from finding a legislative taking).

Like the appellants in *Penn Central*, who showed that the denial of a permit to build a 53-story tower atop their train station cost them literally millions of dollars in potential rents, 438 U.S. at 116, 98 S.Ct. at 2655, plaintiffs in the present case argue that the economic impact of the prepayment restrictions can be measured in the millions of dollars, since the restrictions prevent plaintiffs from converting their properties to more profitable uses.[17]

Again like the appellants in *Penn Central*, the plaintiffs at bar are able to continue to use their property for the same business purposes they have always used it--their "primary expectation," in the words of Justice Brennan. Furthermore, as discussed earlier, LIHPRHA authorizes HUD to award financial incentives to property owners who agree to forbear prepayment or who seek prepayment but have their applications denied. In the terms of *Penn Central*, such

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[17] Although the *Penn Central* appellants ultimately lost their case, "economic impact" evidence can be critical. In *Lucas*, for example, the petitioner had spent $975,000 to purchase two undeveloped parcels of oceanfront land, intending to construct homes on each parcel. His plans were consistent with the zoning ordinances then in effect. But in 1988, before Mr. Lucas could begin construction, the state passed legislation prohibiting new construction in an area which included both of Mr. Lucas's parcels of land. 505 U.S. at 1008-09, 112 S.Ct. at 2889-90.

Similarly, the Federal Circuit in *Loveladies* found that a corporation had been denied economically viable use of a 12.5 acre parcel of land when the Army Corps of Engineers refused to grant a landfill permit pursuant to federal wetlands regulations. The corporation's proposed development would have been permitted under the laws in place at the time the project was initiated. *Loveladies*, 28 F.3d at 1174. As a result of the permit denial, the value of the parcel was reduced from $2,658,000 to $12,500--a reduction of more than 99 percent. *Id.* at 1174-75.

incentives may mitigate the harsh economic impact of the prepayment restrictions, even though they would not necessarily be adequate as "just compensation" in the event of a taking.

Despite the similarities between *Penn Central* and the present case, the record now before the court is inadequate for the court to fulfill its fact-finding obligations with respect to the "economic impact" criterion. As discussed above, the Federal Circuit requires this court to base its conclusions regarding economic impact on a comprehensive factual inquiry which would include consideration of (1) whether the government acted "fairly and reasonably" in implementing the regulation affecting property rights; (2) whether the regulatory regime also provides "direct compensating benefits" and whether those benefits accrue mainly to the property or, instead, to the general public; and (3) whether there are "alternative permitted activities" available to plaintiffs in lieu of prepayment and whether those alternative activities are "economically realistic." *Florida Rock II*, 18 F.3d at 1571.

As it stands, the record of this case contains no information with which the court could determine whether the government has acted "fairly and reasonably" in imposing the prepayment restrictions on the plaintiffs at bar. With respect to whether ELIHPA or LIHPRHA provides "direct compensating benefits" which might mitigate the loss of any putative property rights or permits "economically realistic" alternative activities, it would be necessary to take into consideration the several financial incentives which LIHPRHA authorizes HUD to offer owners who agree to extend the affordability restrictions on their properties. The record before the court, however, contains no information by which the court could

evaluate the economic effect of the availability of LIHPRHA incentives to the plaintiffs in this case. The court believes that the factual record needed to dispose of this issue can be fully developed at trial.

As for the third and final *Penn Central* factor, the degree to which the regulatory imposition interferes with distinct and reasonable investment-backed expectations, defendant argues that plaintiffs' expectations, under the circumstances, were "unreasonable," applying the ruling made by the Supreme Court in *Monsanto*, 467 U.S. at 1005, 104 S.Ct. at 2874. Defendant has emphasized that plaintiffs operate in a highly regulated field, and, therefore, they should have expected that the government might change its mind about allowing plaintiffs to exercise the rights set forth in their deed of trust notes. The Eighth Circuit made the same suggestion in *Parkridge*, the case which challenged the constitutionality of ELIHPA's prepayment restrictions, finding:

> [I]t was foreseeable that the government might impair the partnership's contractual options in order to prevent the programs's purposes from being foiled. Therefore, we cannot agree that Parkridge's expectation of a continued, unrestricted right to prepay was "reasonable."

13 F.3d at 1199. This court cannot wholeheartedly agree with the Eighth Circuit's suggestion that the foreseeability of regulatory change, by itself, implies that plaintiffs have entertained unreasonable expectations. Plaintiffs' prepayment expectations were based on express language contained in their deed of trust notes and authorized by HUD. The prepayment clauses were consistent, moreover, with contemporaneous HUD regulations, and those regulations remained in force for the better part of the

first 20 years of plaintiffs' mortgages. On that basis, the court cannot conclude that plaintiffs' expectations were "unreasonable."[18] The important question with respect to plaintiffs' expectations, therefore, is not whether they were "reasonable," but whether they were "investment-backed."

In support of their position, plaintiffs make the following assertions (in the words of Jona Goldrich, an investor in each of the 21 partnerships which are plaintiffs in this case):

> Because the partnerships intended to prepay the mortgages on the HUD projects after 20 years, they selected project locations which they believed would increase in value and allow them to attract market-rate tenants after the projects were free of HUD restrictions. Although there were available at that time numerous potential development sites on relatively inexpensive land in inner city neighborhoods and in less desirable suburban locations, the partnerships deliberately selected and paid a premium for desirable urban and suburban locations close to shopping, bus routes, schools and other amenities, in contrast to sites selected by most developers of HUD-insured properties.

Goldrich Declaration at paragraph 13.

Mr. Goldrich's statement alleging that he and his partners made special efforts to construct properties that would be more valuable once prepayment rights were exercised, is apparently an effort to satisfy the

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[18] Despite the court's disagreement with certain portions of *Parkridge*, the court must point out that the Eighth Circuit's analysis of the reasonableness of Parkridge's expectations was not essential to the court's ultimate disposition of that case because Parkridge sought to enjoin the implementation of ELIHPA--a remedy not available in a takings case in this court.

requirement that a taking claim be supported by "investment-backed expectations." *In Florida Rock I*, the Federal Circuit suggested that a relevant consideration in this context is to compare a property owner's initial investment with the property's fair market value subject to the regulatory imposition. 791 F.2d at 902. The slim factual record now before the court, however, does not permit such a comparison, so it is not yet clear to what extent Mr. Goldrich's investment in *Cienega Gardens* and the other properties has been diminished by the prepayment restrictions because the record does not reveal information concerning the value of the property before or after the imposition of the prepayment restrictions. Nor is it clear to what extent the amount initially invested in Cienega Gardens or the other properties was based on the possibility of prepayment in 20 years, as opposed to other considerations. Again, trial is needed in order for the court to adequately evaluate the effect of ELIHPA and LIHPRHA on plaintiffs' investment-backed expectations.

D. Claims based on HUD's alleged statutory violations.

In Count III of their complaint, plaintiffs seek damages for HUD's allegedly unlawful (1) delay in implementing regulations as required by LIHPRHA, (2) delay in processing requests for incentives authorized by the legislation, (3) failing to provide for retroactive payment of incentives, and (4) promulgating appraisal guidelines which result in value determinations below fair market value.

The court's recent opinion in *Anaheim Gardens v. United States*, 33 Fed.Cl. 24 (1995), thoroughly discusses the identical issues which the court has here numbered (1) and (3); in accordance with that opinion, those claims are hereby dismissed.

The *Anaheim* opinion did not reach any conclusions concerning the issues raised by numbers (2) and (4)--respectively, HUD's alleged delay in processing requests for incentives and promulgation of appraisal guidelines which result in value determinations below fair market value. With respect to the delays in processing requests for incentives, the court must dismiss this claim for lack of subject matter jurisdiction. LIHPRHA, at 12 U.S.C. § 4115, allows HUD 180 days to process a P.O.A. which requests incentives. At the close of that period, HUD must either approve the incentives or notify the applicant of the reasons for disapproval and of the actions that could be taken to meet the criteria for approval. *Id.* at § 4115(b)(1). The same provision, at subsection (c), also provides the exclusive remedy for untimely HUD action with respect to a P.O.A. According to that provision:

> If the Secretary [of HUD] does not approve a plan of action with the period under subsection (b) of this section, the Secretary shall provide incentives and assistance under this subchapter in the amount that the owner would have received if the Secretary had complied with such time limitations.... *An owner may bring an action in the appropriate Federal district court to enforce this subsection.* (Emphasis added.)

Thus, 12 U.S.C. § 4115(c) provides an exclusive district court remedy for HUD's allegedly delayed action in approving plaintiffs' requests for incentives. While it is true, as plaintiffs argue, that "a Tucker Act remedy exists unless there are unambiguous indications to the contrary," *Preseault v. Interstate Commerce Comm'n*, 494 U.S. 1, 13, 110 S.Ct. 914, 923, 108 L.Ed.2d 1 (1990), the court finds § 4115(c) to be sufficiently unambiguous so as to deny this court jurisdiction.

Finally, with regard to plaintiffs' contention that HUD has promulgated appraisal guidelines which allegedly deny plaintiffs' an appraisal based on the fair market value of their properties, the court must also dismiss this claim for lack of jurisdiction. This court has no authority to order HUD to adopt or change any particular regulation, nor may it declare any particular regulation invalid. In dismissing this claim, however, the court expresses no opinion as to whether plaintiffs may pursue an equitable remedy in another forum for the injuries they allegedly sustained.

CONCLUSION

To summarize, trial is necessary in order to determine damages with respect to plaintiffs' breach of contract claim. Trial is also necessary to determine ripeness, liability and damages with respect to plaintiffs' taking claim. Plaintiffs' claim for damages with respect to HUD's allegedly unlawful or improper administrative actions is hereby dismissed.

IT IS SO ORDERED.

APPENDIX C

UNITED STATES COURT OF FEDERAL CLAIMS

Nos. 94-1C

CIENEGA GARDENS, ET AL., PLAINTIFFS

v.

UNITED STATES, DEFENDANT-APPELLANT.

[Decided Dec. 11, 1996]

OPINION

Before: ROBINSON, Judge:

This case is before the court on defendant's motion for partial summary judgment and new plaintiffs' cross-motion for summary judgment. The original plaintiffs in this action, which are general or limited partnerships who are owner-participants in the programs detailed below, were joined by 21 "new plaintiffs" pursuant to this court's April 1, 1996 Order. This Opinion concerns new plaintiffs' claims. New plaintiffs' first amended complaint seeks damages for breach of contract (Count I), just compensation for a taking under the Fifth Amendment to the United States Constitution (Count II), and damages based on allegedly unlawful and improper administrative actions (Count III).

Defendant moves for partial summary judgment as to Counts I and III. New plaintiffs move for partial summary judgment as to Count I. The court considers

these motions in light of its Opinion in *Cienega Gardens v. United States*, 33 Fed.Cl. 196 (1995) ("*Cienega I*"). As a result, the court grants new plaintiffs' motion for partial summary judgment as to Count I and defendant's motion as to Count III, while denying defendant's motion as to Count I. Additionally, the court denies defendant's motion to strike some of new plaintiffs' claims with regard to Count I.

Factual Background

During the 1960s and 1970s, in response to a national housing crisis, Congress authorized the Department of Housing and Urban Development ("HUD") to provide mortgage insurance, below-market rate loans, and interest subsidies to stimulate private development of low-income resident housing. Each plaintiff agreed, under either section 221(d)(3) or 236 of the National Housing Act, as amended, 12 U.S.C.A. § 1715l(d)(3) & § 1715z-1, to construct such housing and entered into Regulatory Agreements with HUD governing their operation. The mechanics of the program were such that each plaintiff entered into a long-term deed of trust with a private lender by executing a note. The terms regarding prepayment of the mortgages were contained within a rider to the deed of trust notes; the Regulatory Agreement each plaintiff entered with HUD made no mention of prepayment rights. HUD endorsed each note and stated the note was insured under either section 221(d)(3) or section 236 and federal regulations in effect at the time. Also, HUD entered into a contract of mortgage insurance with each lender. Defendant has claimed that HUD was not a party to the note, but merely insured the note by endorsing the mortgage.

Depending on the type of note involved, there were certain restrictions placed upon the project owner's ability to prepay the mortgage. A section 221(d)(3) note

forbade prepayment without HUD approval until 20 years after the original HUD endorsement of the note. Additionally, the owner had to be a limited distribution mortgagor. Under a section 236 note, prepayment was also forbidden without HUD approval unless either to release an individual unit for sale under specified conditions, or until 20 years had passed, provided the maker of the note was a limited distribution mortgagor not receiving payments under a rent supplement contract. Plaintiffs claim that the right to prepay was a material term of their contracts with the government without which they would not have entered into these agreements. Plaintiffs have stated that but for congressional action, they would have prepaid their mortgages, terminated the Regulatory Agreements, and maximized their investments by converting the projects to more profitable, conventional uses.

Through the enactment of the Emergency Low Income Housing Preservation Act ("ELIHPA" or "Title II"), which took effect on February 5, 1988, a temporary moratorium was placed upon prepayment rights. Pub.L. 100-242, 101 Stat. 1877 (reprinted as amended at 12 U.S.C.A. § 17151 (note) (West 1989)). To prepay, plaintiffs claimed ELIHPA required them to demonstrate that their prepayment would not materially affect the availability of decent housing for low-income families near job opportunities and would not affect minority housing opportunities within the communities in which the properties were located. If owners were unable to satisfy these conditions for prepayment (or if they desired to remain in the program), HUD was authorized to provide them with financial incentives.

As ELIHPA was intended to serve only as a temporary measure, Congress passed the Low-Income Housing Preservation and Resident Homeownership

Act of 1990 ("LIHPRHA" or "Title VI"). Pub.L. 101-625, 104 Stat. 4249 (reprinted at 12 U.S.C.A. § 4101 *et seq.*. (West 1993)). LIHPRHA continued ELIHPA's restrictions on prepayment and provided that any prepayment not in compliance with the provisions of Title VI was null and void. The conditions for obtaining HUD's allowance of prepayment were essentially the same in Title VI as they were in Title II. Plaintiffs have claimed they have been unable to satisfy the prepayment conditions of either act.

In *Cienega I*, this court adjudicated similar partial summary judgment cross-motions arising from the claims of the original plaintiffs in this case and the contentions of the government. The arguments presented by Cienega *I* plaintiffs are essentially the same as those presented by plaintiffs in the present motion. The court finds no reason to deviate from the substance of its rulings in *Cienega I* and, accordingly, finds for new plaintiffs on the breach of contract claim and for defendant on the statutory damages claim.

Contentions of the Parties

New plaintiffs in this action claim to be limited distribution mortgagors who entered into section 221(d)(3) or section 236 agreements with HUD. None claims to be receiving payments under a rent supplement contract. Each claims it was entitled to prepay its mortgage 20 years after the date of HUD's endorsement. As of the date of this Opinion, prepayment dates have passed for all new plaintiffs and each has been effectively barred from unrestricted prepayment of its mortgage and the contemporaneous emancipation from the regulatory strictures of HUD. Therefore, new plaintiffs allege that defendant has breached its contracts with new plaintiffs through Congressional abrogation of their unfettered prepayment rights.

New plaintiffs also claim that the incentives offered by the Title II and Title VI programs fail to compensate adequately for the alleged breach of their contracts. Further, new plaintiffs claim these incentive programs do not compensate them for the alleged takings of their properties for public use (Count II) or the administrative misconduct alleged in Count III. However, the court does not reach these claims as they are not subjects of new plaintiffs' pending motion. New plaintiffs do claim, however, that their breach of contract claim in the pending motion is governed by the law of the case and, therefore, that the result in *Cienega I* compels the court's disposition of new plaintiff's cross-motion in their favor. *Christianson v. Colt Indus. Operating Corp.*, 486 U.S. 800, 815-16, 108 S.Ct. 2166, 2177-78, 100 L.Ed.2d 811 (1988) (quoting *Arizona v. California*, 460 U.S. 605, 618, 103 S.Ct. 1382, 1391, 75 L.Ed.2d 318 (1983)).

Defendant resurrects its argument from *Cienega I* that it is not a party to an agreement containing prepayment restrictions, and, therefore, could not have breached a provision to which it was not a party. Defendant argues that the prepayment language contained in the notes was intended to bind only each plaintiff and its lender, and that prepayment eligibility was always to be determined by applicable regulations. Defendant claims HUD's approval of the forms used by plaintiff and lender did not indicate an intent by the government to be bound by the terms of those documents, and that there is no evidence of any negotiations or agreements between the parties as to prepayment terms. For this reason, defendant argues it is entitled to partial summary judgment as to all breach of contract claims.

Additionally, defendant claims it is entitled to partial summary judgment as to the claims of

administrative misconduct as would be consistent with this court's ruling in *Cienega I*. Defendant argues that this court lacks appropriate jurisdiction to deal with new plaintiffs' claims in Count III. In Count III, new plaintiffs claim damages for three instances of alleged wrongdoing: (1) unlawful delays in the promulgation of regulations and requests for incentives; (2) failure to provide retroactive payment of incentives; and (3) the promulgation of appraisal guidelines that result in value determinations of new plaintiffs' property at levels far below fair market value.

DISCUSSION

The court will grant a motion or cross-motion for summary judgment where there is no genuine issue of material fact in dispute and the moving party is entitled to judgment as a matter of law. Rule 56(c) of the Rules of the United States Court of Federal Claims ("RCFC"); *Celotex Corp. v. Catrett*, 477 U.S. 317, 322, 106 S.Ct. 2548, 2552, 91 L.Ed.2d 265 (1986); *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 247-48, 106 S.Ct. 2505, 2509-10, 91 L.Ed.2d 202 (1986). The standard for whether there is a material issue of disputed fact is whether a reasonable finder of fact could return a verdict in favor of the non-movant. *Sweats Fashions, Inc. v. Pannill Knitting Co.*, 833 F.2d 1560, 1562 (Fed.Cir.1987). In determining entitlement to summary judgment, the court must resolve any doubts about disputed factual issues in favor of the non-moving party. *Housing Corp. of America v. United States*, 199 Ct.Cl. 705, 710, 468 F.2d 922, 924 (1972). The court may look beyond the pleadings to determine in which party's favor the questions of law will be resolved and whether any apparent issues of fact are merely illusory. Application of those standards leads the court to its decision below.

I. Breach of contract

On the subject of breach of contract, the court finds that this case is controlled by its determination of this issue in *Cienega I*. In that case, the court found that plaintiffs had established a breach of contract claim and that defendant's argument against finding privity of contract was deficient and without merit. In *Cienega I* and this case, "when the parties in this case entered into the regulatory agreement they also intended to be mutually bound by the prepayment rules set forth in the rider to the contemporaneous deed of trust note." *Cienega Gardens*, 33 Fed.Cl. at 210. The contracts at issue in the present case arose from the same set of transactions as the transactions in *Cienega I*. Therefore, the court sees no reason to defy consistency by upsetting or modifying its analysis in *Cienega I*, which found for plaintiffs on the issue of breach.

Defendant, however, raises the issue of subsequent legislation and agreements, which it claims serve as a basis for distinguishing these plaintiffs from the original plaintiffs. The court does not find these arguments persuasive on the issue of breach of contract. There is one question for decision: Did Congress, through promulgation of ELIHPA and LIHPRHA, abrogate each new plaintiff's right to prepay its mortgage after 20 years and free itself from the strictures of HUD's regulatory program?

Defendant advances arguments related to the effect of legislation subsequent to ELIHPA and LIHPRHA and various agreements between defendant and individual new plaintiffs that it claims necessitate partial summary judgment in its favor. There are four categories of such legislation and agreements: (1) the Housing Opportunity Program Extension Act of 1996 ("1996 Act"), Pub.L. 104-120, Section 2, 110 Stat. 834; (2) 40-year rent supplement contracts; (3) section 8 or housing assistance payment ("HAP") contracts; and (4)

HELP loans or earthquake assistance agreements. The court will examine the effects of each. However, by way of preview, the court finds that the 1996 Act does not bar the breach of contract claims of those four new plaintiffs it most directly affects, *i.e.*, those new plaintiffs with prepayment dates following the effective date of the 1996 Act [1] It also fails to restore unfettered prepayment rights for the 17 remaining new plaintiffs. As for the various subsequent agreements between new plaintiffs and defendant, the decision on the question of breach is not disturbed. The effect of those agreements is one for the damages phase of these proceedings; breach is decided for plaintiffs.

To begin, there are five new plaintiffs[2] wholly unaffected by the various legislation and agreements discussed by the parties. For these new plaintiffs, the breach claims remain decided in their favor and they will be unaffected during the damages phase of these proceedings by any mitigatory effect these agreements and legislation may have upon the claims of the 16 other new plaintiffs.

Defendant's argument that the 1996 Act restores prepayment rights fails to absolve it from the breach of contract claims, including those four with prepayment dates subsequent to the 1996 Act's effective date. The 1996 Act fails to restore *unfettered* prepayment rights, rather, it adds new conditions for any plaintiffs seeking prepayment. The liability for breach of contract must be adjudged to remain with the government. Any mitigatory effect that the 1996 Act may have upon the damages suffered by new plaintiffs is more

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[1] Beck Park, Drehmoor Apartments, Livermore Gardens, and Villa Fontana.

[2] Blossom Hill Apartments, Kings Canyon Apartments, Lawrence Road Apartments, Skyline View Gardens, and Village Green.

appropriately addressed in the damages phase of these proceedings. Further, defendant's motion to strike the claims arising out of the 1996 Act, which it claims are outside the scope of the first amended complaint, is denied. As the breach of contract claims arising out of the 1996 Act arise from the same circumstances as alleged in the first amended complaint, the claims are allowed to stand. *White Mountain Apache Tribe v. United States*, 8 Cl.Ct. 677, 682 (1985).

On the question of the other agreements entered into by new plaintiffs and defendant, the court finds that those issues are tangential to the central issue. The court is directly concerned with the question of whether there was a breach of contract by the government. The subsequent and supplementary agreements between defendant and new plaintiffs are more appropriately addressed to the issue of damages.

On the issue of the 40-year rent supplement contracts, which relate to the claims of eleven of the new plaintiffs[3] defendant alleges that the execution of these contracts precludes a finding of breach for these plaintiffs. The court disagrees. These contracts do not alter the fact that defendant breached its contracts with these new plaintiffs through enactment of ELIHPA and LIHPRHA. The effect of these contracts is relegated to their effect upon the damages claims of these new plaintiffs. These contracts may serve to mitigate or even eliminate the damage claims of the new plaintiffs, but they do not require the court to disturb its finding as to the question of liability.

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[3] Argonaut Apartments, Casa San Pablo, Central Park Apartments, Drehmoor Apartments, Fairview Green Apartments, Genessee Park Apartments, Green Hotel, Hollywood Knickerbocker Apartments, Hollywood Plaza, Palo Alto Gardens, and Pico Plaza Apartments.

Ten of the new plaintiffs entered into section 8 or HAP contracts with defendant [4] Defendant claims that the effect of these agreements is to impose use restrictions upon all tenant-occupied units in these projects. According to defendant, these restrictions required the continued maintenance of rent controls even in the event of prepayment by new plaintiffs. Thus, defendant reasons that these ten plaintiffs have suffered no damages by reason of ELIHPA, entitling defendant to partial summary judgment as a matter of law. However, defendant may only be correct with regard to part of the last statement: new plaintiffs may be entitled to no damages if the HAP contracts are found to have such an effect. But that issue fails to speak to the question of liability for the initial breach. While the HAP contracts may affect the damage award, these contracts do not speak to the prepayment issue, and that is the one with which the court presently concerns itself. The court's conclusion that the government breached its original contracts through the abrogation of new plaintiffs' unfettered prepayment rights is maintained. Damages, if any, will be adjudicated later.

Three new plaintiffs [5] received financial assistance from the government for repairs and damages sustained during the January 1994 Southern California earthquake. Defendant claims that these agreements are substituted contracts and that these new plaintiffs agreed to bind themselves to defendant's affordability restrictions for the remaining physical life of the

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[4] Argonaut Apartments, Beck Park, Central Park Apartments, Drehmoor Apartments, Genessee Park Apartments, Grace & Laughter Apartments, Green Hotel, Hollywood Knickerbocker Apartments, Palo Alto Gardens, and Placita Gardens Apartments.

[5] Beck Park, Green Hotel, and Hollywood Knickerbocker Apartments.

property. However, even defendant acknowledges that these new, allegedly substituted contracts did not prohibit prepayment but just required the continued applicability of the affordability restrictions even in the event of prepayment. The court finds that as these contracts, as defendant contends, do not address prepayment, they cannot be superseding contracts on that issue. Thus, these new plaintiffs' breach claims continue to stand. The effects of these contracts will be more appropriately addressed during the damages phase of the proceedings. These contracts may be found to mitigate or eliminate any alleged damages, but they do not disturb the liability determination for new plaintiffs.

In sum, the court looks to its Opinion in *Cienega I* for guidance in the resolution of the present dispute. The court finds here as it did in *Cienega I* that "these promises were made expressly to and for the benefit of the government, not third parties. In exchange, the government agreed to endorse and insure the mortgages . . . and to allow plaintiffs to free themselves of HUD's regulatory strictures after the first 20 years." *Cienega I*, 33 Fed.Cl. at 210. By enacting ELIHPA and LIHPRHA, Congress breached the government's contracts with new plaintiffs. Accordingly, the court grants new plaintiffs' motion for partial summary judgment as to its claim of breach of contract. Also, the court orders a trial on the question of damages at which time any mitigating or aggravating effects of any subsequent agreements upon the issue of damages may be appropriately litigated.

II. Statutory violations by HUD

In Count III of the first amended complaint, plaintiffs raise essentially the same issues on which this court granted summary judgment for defendant in *Cienega I*. In light of that previous ruling and its

remarkable similarity to the circumstances of new plaintiffs and defendant, the court incorporates that portion of the opinion by reference, and accordingly, grants defendant's motion for partial summary judgment as to Count III.

CONCLUSION

To summarize, trial is most likely necessary to determine damages with respect to new plaintiffs' breach of contract claim. New plaintiffs' claim for damages with respect to HUD's allegedly unlawful or improper administrative actions is hereby dismissed. By implication, trial is also necessary with respect to new plaintiffs' taking claim, an issue not presented in the RCFC 56(c) cross-motions here adjudicated. The parties shall file a joint status report proposing a schedule for further proceedings within 30 days.

IT IS SO ORDERED.

APPENDIX D

UNITED STATES COURT OF FEDERAL CLAIMS

Nos. 94-1C

CIENEGA GARDENS, ET AL., PLAINTIFFS

v.

UNITED STATES, DEFENDANT-APPELLANT.

[Decided Apr. 29, 1997]

DAMAGES OPINION

Before: ROBINSON, Judge:

The issue before the court is the precise measure of damages to which plaintiffs are entitled. This Opinion shall be read in conjunction with the court's March 25, 1995 Opinion on liability, *Cienega Gardens v. United States*, 33 Fed.Cl. 196 (1995) ("*Cienega I*"), in which the court held that: (1) plaintiffs have established privity of contract between themselves and the government; (2) the Department of Housing and Urban Development ("HUD" or "the agency") was authorized to enter into enforceable contracts with plaintiffs; and (3) defendant breached its contracts with plaintiffs.

While *Cienega I* set forth the court's analysis in finding breach of contract[1] the factual record then

[1] Having found breach of contract and the need for trial on damages, the court denied defendant's motion to dismiss and plaintiffs' cross-motion for partial summary judgment on the alternate Fifth Amendment takings issue.

before the court contained insufficient evidence for the court to assess damages. For that reason, trial was necessary to develop the constellation of facts regarding the contract claim for the purpose of quantifying damages. This damages trial was held in the National Courts Building, Washington, D.C. on November 18-21, 1996. Following trial, the parties filed simultaneous post-trial briefs on January 17, 1997, discussing further their respective theories on the accounting issues. Finally, the court conducted a site visit on February 7, 1997, in the presence of counsel to clarify matters impacting market rate determinations of the four model properties that remained unclear following trial and the filing of the post-trial briefs. After careful consideration of the arguments, testimony, exhibits, and applicable law, the court concludes that plaintiffs are entitled to damages in the amount of $3,061,107 for the four model properties.

Background

During the 1950s and 1960s, Congress enacted legislation to encourage private developers to construct, own and manage housing projects for low- and moderate-income families. To implement the legislation, Congress authorized first the Federal Housing Administration and later HUD[2] to provide mortgage insurance to enable private lending institutions to provide low-interest mortgages to housing developers.

Housing developers received financial incentives along with mortgage insurance under either of two programs. The first, referred to as "Section 221," provided for below-market mortgage rates. Pub.L.

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[2] In 1965, the Federal Housing Administration, headed by the Federal Housing Commissioner, was subsumed into the newly established Department of Housing and Urban Development. *See* 24 C.F.R. §§ 200.1-200.4 (1994).

83-560, 68 Stat. 590, 599 (1954), *amended by* Pub.L. 87-70, 75 Stat. 149 (1961). Developers who obtained mortgages after 1968, however, were subject to a new provision enacted that year known as "Section 236." Developers who participated in the Section 236 program received market-rate mortgages with an interest subsidy. Pub.L. 90-448, 82 Stat. 498, 499 (1968). In either case, developers were expected to pass on these financial benefits to their tenants in the form of lower rents. *Id.*

Plaintiffs[3] are owned by real estate partnerships bearing names corresponding to the properties. Created under the laws of California, each of these partnerships developed and operated low-income rental housing projects with mortgage loans insured pursuant to section 221(d)(3) or section 236 of the National Housing Act, *codified as amended* at 12 U.S.C. §§ 1715*l*(d)(3), 1715z-1 (1994). Each of these properties has been managed from inception by Goldrich & Kest ("G&K") Management Co., Inc. or by its predecessor, a property management firm wherein Jona Goldrich and Sol Kest held a controlling interest. G & K is among the most experienced California-based management companies with one of the largest HUD portfolios of owned and operated properties.

Typically, when a developer received a HUD-insured mortgage under one of these programs,

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[3] To promote judicial economy and conserve the parties' resources, defendant and the 42 plaintiffs selected four "model plaintiffs" for the purposes of litigating the damages trial. They are as follows: (1) the Sherman partnership owns Sherman Park Apartments (135 units); (2) the Independence partnership owns Independence Park Apartments (78 units); (3) the St. Andrews partnership owns St. Andrews Gardens Apartments (192 units); and (4) the Pico partnership owns Pico Plaza Apartments (42 units), which was added as a "new plaintiff" by the First Amended Complaint.

the developer signed a long-term deed of trust note[4] with a private lender. HUD would then endorse the note. In 1970-1972, each of the four partnerships executed 40-year deed of trust notes: Sherman in the amount of $1,703,000 in favor of United California Bank; Independence in the amount of $1,134,900 in favor of Union Bank; St. Andrews in the amount of $3,181,600 in favor of Union Bank; and Pico in the amount of $700,900 in favor of Prestige Mortgage Corporation. All of these lenders are HUD-approved mortgagees. Each of these deed of trust notes bore a "Rider A" agreement. Rider A to the Sherman deed of trust note provided in relevant part that:

> The debt evidenced by this Deed of Trust Note may not be prepaid in whole or in part, prior to the final maturity date hereof without the prior written approval of the Federal Housing Commissioner, except a maker which is a limited distribution mortgagor may prepay without such approval after twenty (20) years from the date of final endorsement of this Deed of Trust Note by the Federal Housing Commissioner.

Rider A to the Independence, St. Andrews, and Pico deed of trust notes provided in relevant part that:

> The debt evidenced by this Deed of Trust Note may not be prepaid, either in whole or in part, prior to the final maturity date hereof without the prior written approval of the Federal Housing Commissioner, except where: (1) the prepayment is in connection with the release of an individual unit for sale to a lower

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[4] This Opinion, for the sake of convenience, uses the terms "mortgage" and "deed of trust note" interchangeably, although the court is aware of their distinctions, which are rooted in state law. *See* Black's Law Dictionary 373 (5th ed. 1979).

> income, elderly, or handicapped person; or (2) the Maker is a limited distribution mortgagor which is not receiving payments from the Commissioner under a rent supplement contract pursuant to Section 101 of the Housing and Urban Development Act of 1965, and the prepayment occurs after the expiration of twenty (20) years from the date of final endorsement of this Deed of Trust Note by the Commissioner or as a result of a sale of the project to a cooperative or nonprofit corporation or association and the purchase is financed with a mortgage insured pursuant to Section 236(j)(3) of the National Housing Act as amended.

Simultaneously, the developers entered into "regulatory agreements" with HUD, which placed certain conditions on the mortgages. The regulatory agreements imposed restrictions on the operation of the projects, including: the income levels of tenants; the rents that could be charged; and the rates of return that the developer could receive (collectively "affordability restrictions"). The regulatory agreements imposed upon the owners several additional obligations, including a requirement to make all mortgage payments to lenders when due and to maintain substantial cash reserves--obligations which were designed to limit the government's financial exposure under its insurance contract.[5] The regulatory

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[5] Plaintiffs also draw the court's attention to paragraph 12 of the regulatory agreement, which effectively placed a lien on the mortgaged property in favor of HUD:

> [T]o secure the Commissioner because of his liability under the endorsement of the note for insurance, and as security for the other obligations under this Agreement, the Owners respectively assign, pledge and mortgage to the Commissioner their rights to the rents, profits, income and charges of whatever sort which they might receive or be

agreements, as well as the mortgage insurance provided by HUD, were to remain in effect as long as the mortgage loan remained outstanding.

While the regulatory agreement made no mention of the owner's prepayment rights, Rider A to the HUD-endorsed deed of trust notes expressly prohibited prepayment of the mortgages before 20 years from the date of endorsement, except under certain conditions which included HUD approval of the prepayment. The notes further stated that, after making payments for 20 years, owners could prepay their mortgages in fill without prior HUD approval. The deed of trust notes were printed on forms approved by HUD. The prepayment rules as set forth in the notes reflected contemporaneous HUD regulations, 24 C.F.R. §§ 221.524(a)(1)(ii) and 236.30(a)(i) (1970),[6] which govern Section 221 and Section 236 programs. Those regulations also contained language which generally reserved to HUD the right to make future amendments:

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entitled to receive from the operation of the mortgaged property.... Until a default is declared under this Agreement, however, permission is granted to Owners to collect and retain under the provisions of this Agreement such rents, profits, income, and charges, but upon default this permission is terminated as to all rents due or collected thereafter.

[6] The language in the Section 221 regulations regarding mortgage prepayment was essentially the same as that in the Section 236 regulations, which in pertinent part stated:

§ 236.30 Prepayment privileges.

(a) *Prepayment in full--(1) Without prior Commissioner consent.* A mortgage indebtedness may be prepaid in full and the Commissioner's controls terminated without the prior consent of the Commissioner where....

(ii) [T]he prepayment occurs after the expiration of 20 years from the date of final endorsement of the mortgage....

§ 221.749 Effect of Amendments.

The regulations in this subpart may be amended by the Commissioner at any time, and from time to time, in whole or in part, but such amendment will not adversely affect the interests of a mortgagee or lender under the contract of insurance on any mortgage or loan already insured and shall not adversely affect the interests of a mortgagee or lender on any mortgage or loan to be insured on which the Commissioner has made a commitment to insure.

§ 221.524 Prepayment privileges.

(a) Prepayment in full--(1) Without prior Commissioner consent. A mortgage indebtedness may be prepaid in full and the Commissioner's controls terminated without the prior consent of the Commissioner . . .

24 C.F.R. § 221.524(a)(ii)(1970). All of the plaintiffs in this case are general or limited partnerships who are owner-participants in the Section 221 or Section 236 programs. The housing projects they own are all located in Los Angeles, CA. The original prepayment dates and existing mortgage balances as of the corresponding prepayment dates were: $1,343,461 for Sherman on September 12, 1992; $910,407 for Independence on June 11, 1993; $2,986,682 for St. Andrews on December 19, 1991; and $560,860 for Pico on December 27, 1993. To this day, none of the owners has prepaid. HUD approved insurance on almost the entire amount of the deed of trust notes pursuant to Sections 221(d)(3) and 236 of the National Housing Act. The amounts and dates of final HUD endorsement were: $1,582,900 for Sherman on September 13, 1972; $1,129,400 for Independence on June 12, 1973;

$3,181,600 for St. Andrews on December 20, 1971; and $698,400 for Pico on December 28, 1973.

By the late 1980s, Congress became concerned that a large number of owners might take advantage of the prepayment clauses within a short period of time, thus drastically reducing the supply of low-income rental housing throughout the country. *See* S.REP. NO. 316, 101st Cong., 2d Sess. 105, *reprinted in* 1990 U.S.C.C.A.N. 5763, 5867. As a result, Congress enacted two pieces of legislation to directly counter the threat of massive prepayments. The first bill, the Emergency Low Income Housing Preservation Act of 1987 ("ELIHPA" or "Title II") was enacted in 1987. Pub.L. 100-242, 101 Stat. 1877, *reprinted* as amended at 12 U.S.C.A. § 1715*l* (note) (West 1989). ELIHPA effectively placed a two-year moratorium on prepayments in order to give Congress breathing room with which to devise a permanent solution. *Id.* § 221(b). While it did not prohibit prepayments altogether, ELIHPA did require owners to apply to HUD for permission to prepay. *Id.* § 222. ELIHPA authorized HUD to approve a prepayment only after making written findings that the prepayment would have minimal effects on the existing tenants, the local low-income housing market in general, and the local housing market for minorities. *Id.* § 225.[7]

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[7] The text of § 225(a), which is specifically applicable to prepayment, reads in pertinent part:

> The Secretary may approve a plan of action that involves termination of the low income affordability restrictions only upon a written finding that--
>
> (1) implementation of the plan of action will not materially increase economic hardship for current tenants... or involuntarily displace current tenants (except for good cause) where comparable and affordable housing is not readily available, determined without regard to the availability of Federal housing assistance that would

In 1990 Congress replaced ELIHPA with the Low Income Housing Preservation and Residential Homeownership Act of 1990 ("LIHPRHA" or "Title VI"). In addition to making permanent the moratorium on prepayment, LIHPRHA authorized HUD to provide incentives to owners to maintain the affordability restrictions on their properties.[8] Pub.L. 101-625, 104 Stat. 4249, *codified at* 12 U.S.C.A. § 4101 *et seq.*. (West 1993).[9]

Under LIHPRHA, whether a developer wishes to prepay the mortgage or to apply for incentives, the

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address any such hardship or involuntary displacement; and

(2)(A) the supply of vacant, comparable housing is sufficient to ensure that such prepayment will not materially affect--

(i) the availability of decent, safe and sanitary housing affordable to lower income and very low-income families or persons in the area that the housing could reasonably be expected to serve;

(ii) the ability of lower income and very low-income families or persons to find affordable, decent, safe, and sanitary housing near employment opportunities; or

(iii) the housing opportunities of minorities in the community within which the housing is located. . . .

These limitations on HUD's discretion to approve prepayments have essentially been preserved at 12 U.S.C. § 4108.

[8] The incentives authorized by LIHPRHA include authorization to increase ceilings on rents, an increase in the authorized annual rate of return from participating properties, financing of capital improvements, and equity loans, among other things. 12 U.S.C. § 4109.

[9] LIHPRHA was passed upon the expiration of ELIHPA. Under § 203(a) of ELIHPA, the prepayment restrictions were to expire two years after its enactment, or February 5, 1990. 12 U.S.C. § 1715*l* (note, § 203(a)). ELIHPA's expiration date was extended three times, the last time until November 30, 1990, or the date of the enactment of LIHPRHA, whichever was earlier. Pub.L. No. 101-494 at 2. Congress eventually passed LIHPRHA on November 28, 1990.

same procedures apply. The process is begun when a property owner files a Notice of Intent ("NOI") with HUD, "in the form and manner" prescribed by the agency, with copies to be sent to state and local housing authorities, mortgagees, and tenants. 12 U.S.C. § 4102. The property must then be appraised by two independent appraisers to determine its "preservation value," which in turn becomes a basis for any incentives which are ultimately offered to the owners. 12 U.S.C. § 4103; *see also id.* §§ 4104(a), 4110(d). Within nine months after receiving an NOI, or six months if the NOI proposes to terminate affordability restrictions, HUD must send the owner a report containing the results of the appraisals and other information necessary for the owner to proceed. 12 U.S.C. § 4106. The owner must then, within six months, file a Plan of Action ("POA") with HUD, indicating whether the owner wishes to prepay the mortgage (terminating the affordability restrictions), extend the affordability restrictions by requesting incentives, or sell the property to a buyer who will agree to maintain the affordability restrictions. 12 U.S.C. § 4107. When passing upon prepayment requests, HUD applies a test that granted such requests as long as prepayment would not materially increase economic hardships on existing tenants, involuntarily displace such tenants, or decrease the availability of decent, safe, sanitary low-income housing. 12 U.S.C. § 4108.

HUD must approve or disapprove a POA within 180 days of filing, provided the POA is not deficient. 12 U.S.C. § 4115(b). If a POA requesting incentives is approved after the 180 days have passed, LIHPRHA requires that the incentives be retroactive to 180 days after the filing of the POA. 12 U.S.C. § 4115(c). To ensure the timeliness of HUD's POA approval process, LIHPRHA allows an owner to seek relief in federal

district court if HUD does not approve the POA within the statutory time limit. *Id.*

Finally, on March 28, 1996, Congress passed the Housing Opportunity Extension Act of 1996 ("HOPE" or "the 1996 Act"), Pub.L. No. 104-120, which directed the Secretary of HUD to use appropriated HUD-insured housing program funds to permit program participants to prepay their existing mortgage balances. Such prepayment was conditioned on an agreement by the owners not to raise rents for 60 days. "The legislation also provides owners the opportunity to prepay their mortgages or request voluntary termination of a mortgage insurance contract, as long as the owner agrees not to increase rents for 60 days after such prepayment." H.R.REP. NO. 104-384, at 47 (1995) (effecting H.R.2099, 104th CONG. (1995)).

Throughout the early 1980s, the owners of three of the four model properties (Sherman, Independence, and St. Andrews) at issue entered into Section 8 Housing Assistance Payment ("HAP") contracts pursuant to 24 C.F.R. § 886, Subpart A; the United States Housing Act of 1937, 42 U.S.C. § 1437, *et seq.*; and the HUD Development Act, 42 U.S.C. § 3531, *et seq.* Among other things, these contracts restricted the use of low income rental units and the rents chargeable thereon. Section 27(c) of these contracts also provided that any prepayment of plaintiffs' existing mortgage balances would not, in and of itself, affect any of the property owners' or HUD's rights under the HAP contracts. Throughout the 1980s and the early 1990s, the owners of these three model properties renewed the effective terms of these HAP contracts for five-year periods. In 1994 and 1995, the government also provided emergency assistance loans to the Title VI plaintiffs following the Southern California earthquake of January 17, 1994. This assistance was received

pursuant to the HUD Earthquake Loan Program ("HELP"), which provided funds for the costs of limited and major repairs, relocation, demolition, retrofitting, etc. in exchange for the property owners' agreement to provide affordable, use restricted dwelling units for a period of 10-15 years or until the HELP loan was repaid.

In *Cienega I*, this court found that, by signing the regulatory agreement and the deed of trust note to which the regulatory agreement referred, plaintiffs promised to construct and maintain housing in accordance with HUD's specifications, to accept only low- or moderate-income persons as tenants, to charge no higher rents than those permitted by HUD, to distribute profits to shareholders in accordance with specified limitations, to make timely payments on their mortgages and to maintain cash reserves to self-insure against mortgage default. These promises were made expressly to and for the benefit of the government, not third parties. In exchange, the government agreed to endorse and insure the mortgages, allowing plaintiffs to obtain either subsidized commercial loans or loans at favorable interest rates, and to allow plaintiffs to free themselves of HUD's regulatory strictures after the first 20 years. Accordingly, the court found that Congress, by enacting Titles II and VI, breached the government's contracts with plaintiffs, because ELIHPA and LIHPRHA placed restrictions on the right to prepay existing mortgage balances, which would otherwise have been unrestricted after 20 years. Further, this court determined that neither the sovereign acts doctrine nor the unmistakability doctrine was availing to the government to escape liability for breach of contract.

Contentions of the Parties

As a result of the government's breach of contract, plaintiffs contend that they are entitled to $3,420,864 in damages for the four model properties at issue, St. Andrews Gardens and Sherman Park under Title II and Independence Park and Pico Plaza under Title VI. Plaintiffs contend that defendant must pay damages to plaintiffs for the loss of market rents caused by the government's breach. Damages in the form of market rents, argue plaintiffs, were reasonable, foreseeable, directly caused by the breach, and appropriate regardless of whether plaintiffs were new businesses.

Plaintiffs also argue that the Los Angeles Rent Stabilization Ordinance ("LARSO") does not in any way reduce the measure of damages to which plaintiffs are entitled. The subject properties were specifically exempted from LARSO and, upon prepayment, would not have been subject to this ordinance. In the alternative, plaintiffs contend that LARSO is preempted by federal law, specifically the preemption provision found in LIHPRHA.

Plaintiffs contend that there is overwhelming evidence showing that they would have prepaid their mortgages and terminated their participation in the HUD programs but for the enactment of ELIHPA and LIHPRHA. Plaintiffs further argue that their damages award should be neither barred nor reduced as a result of HUD's forced extensions of their Section 8 Rent Subsidization contracts. According to plaintiffs, they were compelled under economic duress to renew these contracts in order to meet their long term mortgage payment obligations. Therefore, these contracts, argue plaintiffs, are unenforceable and, if nothing else, constitute an attempt by plaintiffs to mitigate the damages flowing from the government's breach. Similarly, plaintiffs argue that their damages award

should not be offset by their acceptance of post-POA relief pursuant to the HUD Earthquake Loan Program.

Finally, plaintiffs maintain that the court should adopt the damages model of plaintiffs' expert witness. Plaintiffs contend that this economic model is comprehensive and based on objective, verifiable data pertaining to rents, vacancy rates, and operating expenses. In contrast, defendant's economic model, argue plaintiffs, is subjective and plagued by glaring errors, material omissions, and incorrect assumptions. Plaintiffs argue that defendant's economic experts failed to correctly consider the effect of debt service calculations, HUD interest rate subsidies, management fees, post-prepayment restrictions, consideration of HELP loans, conversion costs, and the costs of processing POAs. Moreover, plaintiffs believe that once these shortcomings are rectified, defendant's damages model varies from plaintiffs' by only a narrow margin of error. For these reasons, plaintiffs insist that their economic model should be adopted by the court since it may be easily applied to the remaining litigation without requiring individualized judgment calls and miring the court in costly, additional evidentiary and valuation hearings.

Defendant argues that plaintiffs are entitled to no damages for the government's breach of contract. In fact, defendant contends that plaintiffs actually benefited from their participation in the HUD programs and accuses plaintiffs of trying to recover lost rental profits to which they are not entitled. Such damages for lost profits, argues defendant, are too remote, contingent and speculative to be properly recovered. Defendant also challenges plaintiffs' damages theory as being flawed in that it understates the size of the conventional loans that plaintiffs would have obtained had they prepaid their HUD-insured

mortgages. That is, it incorrectly assumes that if plaintiffs had been allowed to prepay, they would have obtained conventional loans in substantially smaller amounts than they could have obtained using the subject properties as security. Thus, defendant argues that under market conditions plaintiffs' estimated operating cash flow is greatly exaggerated while their debt service is unrealistically understated.

The government asserts that the Section 8 HAP contracts by three of the four model properties restricted the use of low income rental units and the rents chargeable thereon. Plaintiffs, therefore, were precluded from converting the dwelling units covered by the Section 8 contracts to conventional rental units on the 20 year prepayment date or during any time period for which damages are sought. Defendant argues that plaintiffs' position that they had no realistic option other than to renew the HAP contracts is without merit. Defendant claims that plaintiffs could have chosen to exit the program rather than renewing, thereby charging those fair market rental rates permitted by the regulatory agreements. Thus, defendant contends that those plaintiffs who entered into Section 8 HAP contracts, or at least renewed them following enactment of ELIHPA and LIHPRHA, have suffered no damages.

Even if plaintiffs could have prepaid their HUD-insured mortgages and converted the subject properties to conventional rental income properties, defendant maintains that LARSO would have applied and limited the rents plaintiffs could have charged. To properly evaluate plaintiffs' argument that but for the enactment of ELIHPA and LIHPRHA prepayment and conversion to conventional were certain, defendant contends that the court must eliminate consideration of these two acts, including LIHPRHA's preemption

provision, when examining plaintiffs' damages claims. Thus, defendant asserts that LIHPRHA's preemption provisions are no shield to LARSO's indirect prohibition of prepayment and conversion.

Defendant also disputes plaintiffs' calculations. Defendant argues: (1) even if plaintiffs were able to prepay, convert to conventional and charge market rents, the claimed market rents are too high; (2) the claimed costs of plaintiffs' identity-of-interest property management firm, G & K Management Co., Inc., of processing POA's are too high and unsubstantiated; and (3) plaintiffs claimed legal expenses associated with the preparation and processing of POA's are inappropriate, non-recoverable consequential damages for which there is no mandating statute.

Discussion

The purpose of an award of damages is to "place the non-breaching party in as good a position as it would have been if the contract had been completely performed and without charging the breaching party with harms that he had no sufficient reason to foresee when the contract was made." *Northern Helex Co. v. United States*, 207 Ct.Cl. 862, 875-76, 524 F.2d 707, 713, n. 13 (1975) (declining to award damages that were too uncertain and remote), *cert. denied*, 429 U.S. 866, 97 S.Ct. 176, 50 L.Ed.2d 146 (1976); *see also* Restatement (Second) Of Contracts §§ 329 cmt. a, 335 (1981). In order to recover damages, plaintiffs bear the burden of proving that they have satisfied all the elements of a four-pronged test: (1) the existence of a valid contract between themselves and the United States[10] (2) an

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[10] In passing, the court notes a recent decision that considered the issue of privity in the HUD context. In *Lurline Gardens Ltd. Hous. Partnership v. United States*, 37 Fed.Cl. 415 (1997), property developers entered into regulatory agreements with HUD and into mortgage agreements with private lending

obligation or duty flowing from said contract; (3) a breach of that obligation or duty; and (4) the amount of damages caused by the breach. *San Carlos Irrigation & Drainage District v. United States*, 877 F.2d 957, 959 (Fed.Cir.1989); *Wunderlich Contracting Co. v. United States*, 173 Ct.Cl. 180, 199, 351 F.2d 956, 968 (1965). The first three of these requirements was proved by plaintiffs as indicated in *Cienega I*. In the present case, the benefit necessary to put plaintiffs in as good a position as they would have been but for the breach was precisely their main motivation for entering the HUD program in the first place. While "not every injury resulting from a breach of contract is remedial in damages," *Wells Fargo Bank N.A. v. United States*, 88 F.3d 1012, 1022 (Fed.Cir.1996) (forbidding lost profit damages for transactions clearly unrelated to the

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institutions, which were endorsed by HUD. In *Lurline*, the court summarily rejected the plaintiffs' privity arguments. This court respectfully disagrees with *Lurline*. The fact that a deed of trust note names only the lender and the borrower as parties does not fully resolve the question of whether there is privity of contract between the government and plaintiffs *vis a vis* plaintiffs' prepayment rights. In this court's view, the names of the parties on one of the written agreements is not necessarily dispositive, particularly when the language of the prepayment terms themselves assigns to HUD certain critical rights and obligations in addition to and intertwined with those allocated between the parties to the note. As the Rider agreement made clear, whether a borrower could prepay within the first 20 years was solely within the discretion of HUD, not the lending institution. In other words, a lender's inability to accept prepayment within the first 20 years absent HUD approval does not amount to a lender's right to reject. As evidenced by a sample deed of trust note provided to the court by the parties, the prepayment terms were contained in the Rider agreement, not in the preprinted, HUD-approved deed of trust note forms. In fact, in the sample form, the original prepayment provisions were struck out and a cross-reference was made to the Rider agreement. Regardless, this court found privity of contract by examining all of the documents involved in the transaction and focusing on the substance of the prepayment terms rather than only their location.

breached contract), recovery of lost profits is proper when the plaintiffs prove the elements of a further test with sufficient evidence. *Boyajian v. United States*, 191 Ct.Cl. 233, 423 F.2d 1231, 1235 (1970). To the extent that plaintiffs' damages were foreseeable at the time of contract formation, not at the time of the breach, they are recoverable. *Lucas v. United States*, 25 Cl.Ct. 298, 310 (1992) (citing *Globe Refining Co. v. Landa Cotton Oil Co.*, 190 U.S. 540, 545-47, 23 S.Ct. 754, 756-57, 47 L.Ed. 1171 (1903)).

The three-pronged test for the award of lost profit damages requires that plaintiffs prove: (A) causation; (B) contemplation; and (C) certainty. *See Chain Belt Co. v. United States*, 127 Ct.Cl. 38, 115 F.Supp. 701, 714-19 (1953), *cited as positive authority by, H.F. Allen Orchards v. United States*, 749 F.2d 1571, 1576 (Fed.Cir.1984).

> In order to recover lost profits as damages for breach of contract, [A] it must first appear that such loss is the *immediate and proximate result* of the breach. [B] It must also be established that loss of profits in the event of breach was *within the contemplation* of the contracting parties either (1) because the loss was natural and inevitable upon the breach so that the defaulting party may be presumed from all the circumstances to have foreseen it; or (2) if the breach resulted in lost profits because of some special circumstances, those circumstances must have been known to the defaulting party at the time the contract was entered into to. [C] Finally, there must be established a *sufficient basis for estimating* the amount of profits with reasonable certainty.

Id. (emphasis added); *see also Wm. T. Thompson Co. v. United States*, 26 Cl.Ct. 17 (1992), *aff'd sub nom.*, 24

F.3d 188 (Fed.Cir.1994), *aff'd*, 516 U.S. 417, 116 S.Ct. 981, 134 L.Ed.2d 47 (1996) (holding that elements of this tripartite test were not proven by a plaintiff who incurred speculative damages while defending and settling an earlier, unrelated lawsuit wherein the original claimants were unable to establish injury). Courts have awarded and measured damages in terms of lost profits, however, even in the case of new businesses as long as the measure of lost profits is foreseeable and reasonably reliable, rather than speculatively uncertain. *See Neely v. United States*, 152 Ct.Cl. 137, 146-47, 285 F.2d 438 (1961) (awarding lost profits for government's prohibition on strip mining); *Passaic Distrib., Inc. v. Sherman Co.*, 386 F.Supp. 647, 651-52 (S.D.N.Y.1974) (awarding lost rental profits when landlord unreasonably forbade subletting). Whether a business is new or well-established is not necessarily relevant to an award of lost profit damages so long as a plaintiff can prove the elements of the relevant three-pronged test. *Chain Belt*, 127 Ct.Cl. at 61-64, 115 F.Supp. 701 (holding that increased scale and size or location of business did not necessarily render a business venture new). When showing the measure of damages in terms of lost profits, plaintiffs must prove at least a loss of value to their interest in property, but they need not demonstrate the actual ability to sell at market rates or otherwise. *Hetzel v. Baltimore & O.R. Co.*, 169 U.S. 26, 36-37, 18 S.Ct. 255, 258-59, 42 L.Ed. 648 (1898); *see also* 11 Williston, Treatise On The Law Of Contracts § 1338 (3d ed.1968).

I. Proof of Lost Market-Level Rent Profits

A. Causation

The enactment of ELIHPA and LIHPRHA specifically prevented plaintiffs from exercising the prepayment provisions in their housing agreements. As an inevitable result, they were unable to raise the

rents to market levels. Indeed, that was one of the specific purposes of this legislation, *see* 12 U.S.C.A. § 715*l*(a)(3), Pub.L. 100-242, 101 Stat. 1877, because Congress was concerned that a large number of owners might prepay their existing mortgage balances within a short period of time, reducing drastically the supply of low- income rental housing throughout the country. *See* S.Rep. No. 316, 101st Cong., 2d Sess. 105, *reprinted in* 1990 U.S.C.C.A.N. 5763, 5867. This objective was cemented in 1990 when Congress replaced ELIHPA with LIHPRHA, one of the purposes of which was to make permanent ELIHPA's two-year moratorium on prepayment. Pub.L. 101-625, 104 Stat. 4249, *reprinted* at 12 U.S.C.A. § 4101 *et seq.*. (West 1993). It was clear at trial that, but for LIHPRHA's prohibition of prepayment, plaintiffs intended to take the necessary steps to prepay their existing mortgage balances and to convert their properties to conventional, unrestricted status. *Transcript of Cienega I Damages Trial Record* ("*R.*") at 55-57.

Defendant asserts that causation has not been established since, despite the government's breach, plaintiffs would not have been able to prepay the existing balances on their HUD insured mortgages. The award of lost rental profits, therefore, is improper according to defendant's case. In support of this position, defendant presented evidence challenging the debt service analysis of plaintiffs' economic expert, Dr. Richard Peiser. Defendant argued at trial that even without LIHPRHA's prepayment restrictions, plaintiffs would have been unable to prepay their HUD insured mortgages because they would not have obtained conventional loans in smaller amounts than needed to pay the mortgage balances, as claimed by plaintiffs, but would have borrowed greater amounts at greater costs. In other words, defendant claims that because of extra costs, there is alternate causation in

plaintiffs' inability to convert to conventional properties. Defendant claims that Dr. Peiser admitted that the debt service on a larger 75% loan-to-value leveraging would be substantially higher than the debt service for the smaller loan amounts used in Dr. Peiser's analysis. This would result in a much lower projected cash flow for each housing project. (*R.* at 397-408.) This position, however, accounts for only half of the cash flow. To properly evaluate Dr. Peiser's economic model, one must evaluate all the pros and cons of using different sized loans, including greater amortization, the owners' build-up of equity and the money earned through interest or reinvestment. One cannot simply input a higher conventional loan amount, subtract the correspondingly higher debt service from the projected income, and then argue that the lower operating cash flow--and, therefore, damages--indicates that plaintiffs would not have been able to prepay their loans. Dr. Peiser properly made the conservative assumption that plaintiffs would refinance only up to the amount needed to pay off the outstanding HUD mortgages plus points on the new mortgages.

Even if it were more likely than not that plaintiffs would indeed have borrowed more money at conventional market rates, the economic impact of the additional proceeds from such loans must be taken into account. (*R.* at 405-08.) This impact would be to offset the reduction in operating cash flow and could actually yield higher damages. In fact, plaintiffs' expert testified that his model is actually more conservative in quantifying damages than is defendant's reinterpretation thereof. (*R.* at 407.) Defendant's expert, Mr. Alan Nevin, would have the court treat the larger, proposed refinancing strictly as a cost without considering the commensurate benefit reasonably derived from the additional borrowed funds. (*R.* at 701-02.) Nor did he at least include the potential

benefit as opportunity costs, which as interest, are not recoverable against the government. (*R.* at 696.) This analytical error was admitted by defendant's expert on cross-examination. (*R.* at 694-96, 699.)

The court finds plaintiffs' expert's use of smaller loan amounts with resultant lower debt service and higher projected operating cash flow not only reasonable but preferable to defendant's proposed alternative. In essence, defendant's alternative would inflate the size of plaintiffs' conventional loans without properly offsetting the potential profits from the management and reinvestment of the proceeds realized from the amount included in larger conventional loans not needed to repay the HUD-insured mortgages and financing costs of the conventional loans. If anything, the alternative analysis suggested by defendant, when all factors are taken into account, results in a more remote, contingent, and speculative economic conclusion. Defendant characterizes application of plaintiffs' expert's economic model to this case as "attempting to squeeze a lost rental profits theory of recovery into a shoe that does not fit," *Def.'s Post-Trial Brief* at 31 n. 12, yet Dr. Peiser's assumptions were actually conservative. The court finds Dr. Peiser's economic model more comprehensive and economically rational than that of either of defendant's experts, Messrs. Cunningham and Nevin. Had plaintiffs refinanced more than was needed to pay off the existing loans, they would almost certainly have sought to reinvest the excess principal to produce a greater rate of return than the return produced by the interest rate they would have had to pay for borrowing additional money.

B. Contemplation

The evidence presented during trial strongly indicates that plaintiffs intended from the beginning to

prepay their existing mortgage balances on the original prepayment date and to convert their subsidized properties to conventional ones. (*R.* at 55-57, 114-15.) One of the primary incentives offered by HUD to the property owners to encourage the construction and development of low-income housing, an essential aspect of Sections 221(d)(3) and 236, was the ability of the owners to prepay their existing mortgage balances and terminate HUD restrictions without HUD approval after 20 years. *Cienega I*, 33 Fed.Cl. at 210. This enticement and the corresponding ability to convert to conventional became a material term of the contract. (*R.* at 37-38, 55.) It is clear that without the ability to charge market level rents upon prepayment and conversion to conventional, plaintiffs' anticipated prepayment rights would have been meaningless and purposeless. The contemplated ability to prepay and exit the HUD program upon the 20 year prepayment date is reflected in the precise locations chosen for the properties at issue. After careful study, the court observed that the four representative model properties are all located in middle class neighborhoods and, in general, are equal to or surpass the quality of the neighboring properties in each area. Jona Goldrich of G & K testified that the locations of these properties were specifically chosen, *i.e.*, built or acquired, based on superior location and other attributes to maximize appreciation upon prepayment and conversion to conventional market properties. (*R.* at 37-38.) The evidence indicates that plaintiffs would not have entered into the agreements with HUD but for this long term benefit, which was described as follows:

> It means that the rents will be very high and the market value of the project will be very high, because the limited dividend of the 20 years really didn't justify the effort of dealing with HUD and--the downside risk was small, but the

> work was very hard.... The quality also I was looking for the long run. Make sure that those are low maintenance buildings. That they will be up to date 20 years down the line and be at least as good a quality as the conventional buildings ... being able to add, for example, when there are no more HUD [restrictions,] swimming pools, gyms, spas and things like that to make them competitive with the conventional market.

(*R.* at 38-39 (Goldrich).) While not all of the properties' neighborhoods improved consistently over the 20 year period as originally projected, e.g.., Pico Plaza, this was attributable to unforeseen, external factors such as recent gang activity rather than the maintenance and quality of the property itself (*R.* at 62.) Nonetheless, the court observed during its February 7, 1997 site visit that some of the model properties were in many respects in better condition than neighboring, unsubsidized, conventional properties. Further, the long term benefit of these properties was not limited to converting them to conventional and then raising the rents to market levels. Each of these properties had great potential for refinancing well above the amount owed and reinvesting the proceeds in other investment opportunities or for conversion and resale as condominium complexes. (*R.* at 64-66.) Plaintiffs' injury was contemplated by the parties in that it was the natural and inevitable result of defendant's breach, and the court simply does not believe that plaintiffs entered into the HUD program without intending to reap a commensurate economic advantage as of the 20 year prepayment date. *See Chain Belt Co. v. United States*, 127 Ct.Cl. 38, 115 F.Supp. 701, 714-19 (1953). Defendant's contention to the contrary rings hollow. Plaintiffs' damages, therefore, were not only the natural

and probable, but also the reasonably foreseeable and anticipated consequence of defendant's breach.

C. Certainty

Absolute certainty in quantifying loss of profits is not required. A reasonably certain estimation of the measure of lost profits will suffice to calculate damages, *Chain Belt*, 127 Ct.Cl. at 58-61, 115 F.Supp. 701, as long as that estimation does not claim costs that are "too remote, speculative, and consequential to be compensable as damages." *Northern Helex*, 207 Ct.Cl. at 888, 524 F.2d at 721. Two basic economic approaches were used to quantify damages in this case. The government performed a valuation analysis of the four model properties with HUD restrictions and without as of the prepayment date. This analysis, however, actually supported plaintiffs' position that damages were in excess of $5.141 million if plaintiffs had been allowed to convert and sell the four model properties on the original prepayment date as opposed to selling them as-is or as restricted housing. This was admitted by defendant's real estate economist, Mr. Nevin, at trial. (*R.* at 650-51.) The parties on both sides of this case used the income differential approach, *i.e.*, calculating the difference between the sum of the rental income and benefits plaintiffs actually received during the relevant time frame and the total projected operating cash flow under market conditions (the amount they would have received had they been allowed to prepay, convert to conventional, and charge market rents), to arrive at a damages figure. The *projected* operating cash flow under market conditions is computed by subtracting the sum of *projected* debt service, management expenses, and operating expenses *from* the *projected* rental income. Each of these figures requires accurate data to provide a reliable damages model. While the parties' share the rationale

underlying this basic approach, the data used to forecast their respective damages figures was strikingly different. Not surprisingly, the parties' variant data with respect to three key assumptions produced a substantial discrepancy in the parties' computation of plaintiffs' damages.

1. Rent Levels

In order to arrive at a reliable figure for damages from an income analysis, one must examine market rent figures, which directly affect gross income. Plaintiffs' basis for calculating lost rental income includes the market rent data for the units in their developments. As part of the Title II and Title VI programs, HUD commissioned market appraisals of the properties, which resulted in market rent level guidelines adopted by Congress. Based upon these appraisals, the rent levels were negotiated at arms length and agreed to by HUD as part of plaintiffs' POAs. *See* 12 U.S.C. § 4107; HUD Form 9607; (*R.* at 293-96). These projected rent levels were in turn relied upon by plaintiffs as the most conservative and reliable indicators of market rents when considering their rates of return as of the prepayment date. Thus, plaintiffs claim as lost rental income only the difference between these projected market rent levels and the below-market rents levels plaintiffs were compelled to accept due to defendant's breach of the section 221(d)(3) and 236 contracts. In contrast, defendant has chosen to disregard the HUD agreed-upon rent level projections and, instead, commissioned its own appraisals after the fact.

The court noted at trial that these appraisals performed by defendant's expert, Mr. Cunningham, inevitably and admittedly incorporate his own experience, subjective judgments, and speculative assumptions. (*R.* at 466, 541, 556.) In turn, defendant's other expert, Mr. Nevin, relied on these numbers for

his analysis. (*R.* at 656.) Further, Mr. Cunningham admitted that at least some of the HUD-commissioned, government approved guidelines and appraisals may reflect market rent levels as of the original prepayment dates, though he chose to disregard them in his own analyses. (*R.* at 545.) Defendant also points out that plaintiffs have averaged the market rent levels in the input of their damages model. The court finds that this is not improper, since it will correct for any standard deviation in the agreed-upon rent levels, which again may already conservatively understate the actual rent levels. Contrary to defendant's suggestion, the court cannot countenance adopting admittedly subjective, retrospective appraisals of projected market rent levels when there is a more reliable, verifiable industry data source that was promulgated by the government itself Accordingly, the court finds that the market rent levels used in plaintiffs' economic model are reasonable.

2. Vacancy Rates

Vacancy rates are another key factor in any rental income analysis that directly impacts gross income and, therefore, the damages calculation. Again, plaintiffs' expert utilized verifiable industry data based on surveys of operating properties. When such figures were unavailable, Dr. Peiser used actual G & K experience with similar properties without any manipulation or injection of assumptions. (*R.* at 323-26.) In contrast, defendant's expert, Dr. Nevin, testified that he adjusted the industry data sources upon which he relied to arrive at the relevant vacancy rates. In part, at least, Mr. Nevin's opinion relied on Mr. Cunningham's judgments, which the court has already found to be needlessly subjective. (*R.* at 656-57.) Defendant's expert conceded that it would be reasonable to disagree with the reliability of defendant's reconstructed data. (*R.* at 658.) Given the

ready availability of verifiable industry data, the court so disagrees. Accordingly, the court finds plaintiffs' data to be of greater probative value.

3. Operating Expenses

It is critical under the market scenario to consider the amount of operating expenses plaintiffs would have incurred had they been allowed to prepay their existing mortgage balances. Plaintiffs again chose to rely on verifiable data, *i.e.*, the actual operating expenses under HUD restrictions for those items likely to remain constant under either HUD or market conditions, including taxes, insurance, and utilities. At trial, however, it became clear that certain operating expenses, such as administrative and maintenance expenses, are understandably higher under HUD conditions. The reasons for this include increased wear-and-tear, repairs, and auditing costs. (*R.* at 40-41, 88, 98, 102, 296-97.) This fact is confirmed by defendant's own expert report. *Def.'s Trial Exhibit* ("*DX*") 301 at 74. The recognized industry data source, the Institute of Real Estate Management ("IREM"), also confirms this regarding conventional operating expense data from properties comparable to those at issue. (*R.* at 336-37.) In contrast, defendant again relied on the speculation of its expert witness, Mr. Nevin, who adjusted *conventional* property operating expense data upward according to his judgment and experience even though he actually had little experience with HUD-restricted properties upon which to base a comparison. (*R.* at 657, 671, 674-77.) The project data upon which Mr. Nevin relied were never submitted to the court. Yet defendant's expert admitted that the industry data, the IREM data, are perfectly valid and that his one criticism that IREM data were not age-specific to certain properties would have been negated had he been aware that the average

age of the properties considered by plaintiffs' expert was proper. (*R.* at 673-74.)

The court notes that Mr. Nevin consistently adjusted conventional property operating expenses upward despite the fact that IREM data show such expenses to be lower. Mr. Nevin attributed this simply to an arbitrary choice to round up various figures for reasons he could not satisfactorily explain.

> Q: Where does that [on-site management expense] number come from? . . .
>
> A: Excuse me. Excuse me. Sorry. In that case I just rolled up $25,130 to $26,000. . . .
>
> Q: You *rounded* it up? . . . Any reason you couldn't have just used $25,130? . . .
>
> A: *No reason at all.*
>
> Q: . . . I think you told us in your deposition that the reason you [increased water and sewer expenses by 30%] was you *just had a feeling* that that was the right number, is that correct?
>
> A: Yes, and I am embarrassed to tell you I don't remember the rationale behind it.

(*R.* at 675-76 (emphasis added).) He does not remember the rationale behind it? Arbitrary, subjective upward adjustments such as this to operating expenses render defendant's data questionable. Accordingly, the court again declines to adopt such subjective estimations over reliable, verifiable industry data.

II. The Section 8 HAP Contracts

The government provided Section 8 assistance in the form of HAP contracts, which subsidized the rent balance that was not paid by very low- income tenants. These HAP contracts, which were directly entered into and renewed by the government and three of the four model properties (Sherman, Independence, and St.

Andrews), imposed limitations upon the uses to which the dwelling units could be put.[11] That is, the HAP contracts forbade conversion of the affected dwelling units to conventional. These limitations were independent of the affordability restrictions imposed by the Regulatory Agreements. *Joint Trial Exhibits* ("*JX*") 8-10, 37-39, 61-63. The HAP contracts also provided that "[p]repayment of the mortgage shall not, by itself, affect any rights of the Owner or HUD under this Contract." *Id.* § 27(c). Further, § 28 of these HAP contracts provided:

> To the extent that this Contract conflicts with any agreement(s) between the Owner and HUD, the provisions of this Contract shall be controlling. The provision(s) of the other agreement(s) shall be considered to be amended by the terms of this Contract. Such amendments shall be valid as if such amendment had been made directly to such agreement(s). These

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[11] The court distinguishes the instant case from *National Leased Housing Ass'n v. United States*, 105 F.3d 1423 (Fed.Cir.1997), in which a portion of the plaintiff-property owners entered into Section 8 HAP contracts directly with local housing agencies rather than with HUD, unlike in the case at bar. Those plaintiffs invoked the three-pronged contractor- agency test of *United States v. Johnson Controls Inc.*, 713 F.2d 1541 (Fed.Cir.1983) to argue that as agents of the government, they could sue the government. The Federal Circuit held: (1) HUD did not breach the Section 8 HAP contracts by using comparability studies to bring Section 8 HAP contract rents back into line with comparable, unassisted rents levels; (2) there existed no third-party beneficiary status for property owners who contracted directly with local housing agencies rather than with HUD; (3) there was no privity of contract between the government and those plaintiffs, who contracted directly with local housing agencies rather than with HUD, when the Section 8 contracts do not state that the government will be directly liable for the purchase price; and (4) that HUD's decision to assume the local housing agencies' rights and obligations was discretionary. None of the issues addressed in *National* is on point.

amendments shall be effective only during the term of this Contract.

Defendant relies on these provisions in arguing that the three affected model properties were contractually precluded from converting any dwelling units to conventional on the 20 year prepayment date or during any time period for which plaintiffs seek damages.

Certainly, plaintiffs did not foresee the enactment of ELIHPA and LIHPRHA and, therefore, originally chose to enter into the HAP contracts willingly. While plaintiffs argue that HAP contract renewal was compelled by *economic duress* created by defendant's breach, this does not automatically render all such contracts unenforceable, contrary to plaintiffs' contentions.[12] The doctrine of contractual economic duress requires the claimant to prove that: (1) it involuntarily accepted the offer to contract; (2) there was no reasonable alternative lest the claimant face economic ruin--not merely hardship; and (3) the circumstances necessitating acceptance were the result of the opposing parties' coercion or wrongful conduct. *United Internat'l Investig. Svcs. v. United States*, 33 Fed.Cl. 363, 367 (1995); *Sneeden v. United States*, 33 Fed.Cl. 303 (1995). If such economic duress can be established, "a contract entered into under duress is generally considered not void, but merely voidable, and one who would repudiate a contract procured by duress must act promptly or will be deemed to have elected to affirm it." *Scientific Holding Co., Ltd. v. Plessey Inc.*, 510 F.2d 15, 23 (2d Cir.1974), *cited by, Fayard v. Henry*

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[12] The two cases cited by plaintiffs in support of their economic duress theory, *McLain Plumbing v. United States*, 30 Fed. Cl. 70, 73 (1993) and *Shelton v. United States*, 215 Ct.Cl. 908, 911, 1977 WL 9598 (1977), consider only whether economic duress may render unenforceable agreements for accord and satisfaction, which differ materially from a contractual, bargained-for exchange.

Holt & Co., 726 F.Supp. 438, 447 (S.D.N.Y.1989). Plaintiffs have not substantiated their claims of economic duress. While they have proven that they almost certainly would have faced great financial hardship, there is insufficient evidence to establish that they would have suffered financial ruin if they did not renew the Section 8 HAP contracts. The court concludes, therefore, that there was no economic duress and that the HAP contracts are indeed enforceable.

Under the terms of the HAP contracts, "[p]repayment of the mortgage shall not, by itself, affect any rights of the Owner or HUD under this Contract." *JX* 8, 37, 61 § 27(c). Even if plaintiffs enjoyed the unfettered fight to prepay their existing mortgage balances and convert their properties to conventional, they still would have had to comply with the terms of the HAP contracts. In response, plaintiffs claim that HAP contract renewal under protest and reservation of right was a good faith attempt to mitigate their damages. Quite apart from the issue of breach, it is well-recognized that the non-breaching party bears the duty to mitigate damages. *See Plaintiffs in Winstar-Related Cases v. United States*, 37 Fed.Cl. 174, 186-87 (1997); *Thomas Creek Lumber & Log Co. v. United States*, 36 Fed.Cl. 220, 248 (1996). Whether or not an attempt to mitigate damages is successful, the non-breaching party may recover for injury incurred during such mitigation as long as the attempt was reasonable. *International Fidelity Ins. Co. v. United States*, 25 Cl.Ct. 469, 479 (1992).

> Inasmuch as the law denies recovery for losses that can be avoided by reasonable effort and expense, justice so requires that the risks incident to such effort should be carried by the party whose wrongful conduct makes them necessary. Therefore, special losses that a party

> incurs in a reasonable effort to avoid losses resulting from a breach are recoverable as damages.

5 Corbin, CONTRACTS § 1053 (1964); *see also* 11 Williston, TREATISE ON THE LAW OF CONTRACTS §§ 1353-55 (3d ed.1968). The court, however, is not convinced that plaintiffs' renewal of the Section 8 HAP contracts was motivated more by the desire to mitigate damages than merely to stay afloat economically, for which a benefit was contractually conferred by the government. While HAP contract renewal may have helped plaintiffs avoid great financial hardship, if not ruin, precipitated by the government's breach, plaintiffs did receive consideration in the form of rent subsidization for renewing the HAP contracts.

The dispositive issue then with respect to Section 8 housing assistance is whether plaintiffs would indeed have renewed the HAP contracts, assuming there had been no breach by the government, once their unfettered prepayment rights would have been restored. Defendant argues that plaintiffs could have chosen not to renew the HAP contracts without necessarily facing unreasonable economic duress. According to this view, following the vacancy of low-income tenants, plaintiffs could have rented the units to new tenants who could have afforded the basic, fair market rental rates permitted by the Regulatory Agreements and remained economically viable. This view, mentioned for the first time in footnote 13 of *Defendant's Post-Trial Brief*, is not sufficiently supported by the evidence introduced at trial. In contrast, Carole Glodney, the president of G & K, testified that but for the enactment of ELIHPA and LIHPRHA plaintiffs would never have renewed their HAP contracts beyond their original 20 year prepayment dates.

> Q: I would like to assume for a moment that Title II and Title VI had never been enacted.
>
> A: Okay.
>
> Q: Would the owners have renewed this Section 8 contract for a term extending beyond the term of Exhibit 9?
>
> A: No.
>
> Q: Why not?
>
> A: Because they would have prepaid within a few days of the expiration of this contract and they would not have wanted to renew the contract.
>
> Q: Why wouldn't they have wanted to renew it?
>
> A: It would have limited the rents.
>
> Q: As it turned out though, Title II and Title VI had passed by the time this Section 8 contract came up for renewal. So what decision did the owners make as far as renewing this contract?
>
> A: They decided to go ahead and renew it, because what we are processing under at that time basically was tied into Section 8 contract[s]. So it was needed to renew it.

(*R.* at 138 (capitalization corrected).) Defendant failed to dispute this testimony on cross-examination or elsewhere in the record. Thus, it remains pure speculation whether this course of action was actually economically feasible, as defendant suggests. More importantly, even if it were economically feasible, the need to take such action was occasioned by the government's breach in the first place, since plaintiffs could not prepay as planned. The evidence shows that by renewing the HAP contracts after the government's breach, i.e., after enactment of ELIHPA and

LIHPRHA, plaintiffs were trying to make the most of an unfavorable, economic situation. While renewal may have been neither plaintiffs' ideal action nor the result of economic duress, the dilemma with which they were presented was, at best, a Hobson's Choice. Once constrained to remain subject to the HUD programs' strictures, HUD drove plaintiffs towards reliance on Section 8 housing assistance.

The court has noted that those plaintiffs who entered into the Section 8 HAP contracts with HUD initially did so prior to the enactment of ELIHPA and LIHPRHA. Upon enactment of ELIHPA and LIHPRHA, however, the government's breach essentially forced plaintiffs into an economic position where they had to extend the terms of the HAP contracts to safeguard their economic viability. If plaintiffs could have prepaid their existing mortgage balances and converted their properties to conventional, there would have been no need to extend the terms of the HAP contracts, since rent subsidization would no longer have been needed or desired. Defendant's breach effectively forced plaintiffs to continue renting their units to low-income tenants for the duration of the HUD mortgages (Title II) or the remaining, useful lives of the properties (Title VI) to meet their mortgage payment obligations. HAP contract renewal was also a prerequisite to continued eligibility for Titles II and VI benefits. Finally, plaintiffs' damages model already accounts for the benefits received pursuant to the HAP contracts for the relevant time periods in the Operating Cash Flow Schedules.[13] *See Pl.s' Ex.s* ("*PX*") 200-204. The court

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[13] Plaintiffs' damages model also accounts for the 1996 HOPE post- prepayment restrictions affecting Pico Plaza as a result of the mandatory 60 day rent freeze provision. (*See R.* at 300-01.)

accepts the exhaustive accounting in plaintiffs' damages model and concludes that it is not necessary to count those benefits twice against the damages award. Accordingly, the Section 8 HAP contracts are valid and enforceable, and renewal thereof shall not offset plaintiffs' calculated damages for any of the properties.

III. The HUD Earthquake Loan Program ("HELP")

On January 17, 1994, Southern California was rocked by a major seismic event, an earthquake measuring 6.6 on the Richter scale, which caused substantial damage to many of plaintiffs' properties. *California: State of Shock*, TIME, Jan. 31, 1994, at 19. Plaintiffs accepted financial assistance from the federal government for the costs of damage repairs, relocation, demolition, retrofitting, etc. in exchange for the property owners' agreement to provide affordable, use restricted dwelling units for a period of 10-15 years or until the HELP loan was repaid. *HUD HELP Notices H94-15 (March 17, 1994), H94-25 (April 15, 1994).* Defendant has argued that these agreements are substituted contracts and that these new plaintiffs agreed to bind themselves to defendant's affordability restrictions for the remaining physical life of the property. However, even defendant acknowledged that these new, allegedly substituted contracts did not prohibit prepayment but just required the continued applicability of the affordability restrictions even in the event of prepayment. The court has concluded that as these contracts do not address prepayment, they cannot be superseding contracts on the issue of prepayment. *See Cienega Gardens v. United States*, 37 Fed.Cl. 79 (1996) ("*Cienega II*"). The issue of whether the use of HELP funds offsets damages remains.

Defendant's model, however, ignored the effect of this provision completely.

As an initial matter, the court notes that the acceptance of HELP funds came well after the enactment of LIHPRHA. The Titles II and VI "Terms and Conditions" sections of the HELP Notices state that, if at any time the owners failed to maintain either the requisite low-income proportionality or HUD's Quality Standards ("HQS"), the HELP loans would immediately become due and payable at an accrued, Small Business Administration ("SBA") interest rate of 4% per annum. *Id.* This provision clearly indicates that HUD intended the use restrictions to be concurrent with the life of the loan rather than the life of the property. Further, plaintiffs understood that the use restriction obligations under the terms of the HELP loans were also contingent on their receipt of Title VI benefits, which were ultimately not received as a result of Congress' decision not to fund that program. (*R.* at 190.) Finally and perhaps most importantly, plaintiffs concede that their damages should be offset to the extent they benefitted from the reduced HELP interest rate. Plaintiffs thus accounted for the benefits received via the HELP loans by reducing their damages model's calculation by the interest rate savings for the expected duration of the loans. Plaintiffs' expert economist explained,

> it's a small number, but it is a very real benefit to the owners from having stayed under the HUD restrictions. They were eligible for a special earthquake loan called a HELP loan at one percent interest.... So we are simply measuring the interest rate savings of about $2,300 ... in essence, a benefit to the government, and a reduction in the damages we claim.

(*R.* at 312-13); *see also Pl.s 'Demonstrative Ex.* ("*PDX*") 16. In contrast, defendant neither challenged plaintiffs'

accounting nor posited its own treatment with respect to these HELP benefits satisfactorily at trial, in its damages models, in either of its expert reports, or in its post-trial brief The court finds the testimony of plaintiffs' expert probative and very credible. Therefore, the acceptance of HELP assistance shall not further offset plaintiffs' damages any more than already accounted for in Dr. Peiser's damages model.

IV. The Los Angeles Rent Stabilization Ordinance ("LARSO")

At all times relevant to the case at bar, the City of Los Angeles had a rent stabilization ordinance, codified at Chapter XV, Los Angeles Municipal Code, which makes it "unlawful for any landlord to demand, accept or retain more than the maximum adjusted rent permitted pursuant to [LARSO] or regulations or orders adopted pursuant to [LARSO]." Plaintiffs argue that LARSO does not in any way reduce the measure of damages to which plaintiffs are entitled. The subject properties were specifically exempted from LARSO and, upon prepayment, would not have been subject to this ordinance. In the alternative, plaintiffs contend that LARSO is preempted by federal law, specifically the provision found in LIHPRHA entitled "Preemption of State and local laws." *See* 12 U.S.C. § 4122(a). Defendant maintains that even if plaintiffs could have prepaid their HUD-insured mortgages and converted the subject properties to conventional, LARSO would have limited the rents plaintiffs could have charged. Defendant further contends that to properly evaluate plaintiffs' argument that but for the enactment of ELIHPA and LIHPRHA prepayment and conversion to conventional were certain, defendant contends that the court must eliminate consideration of these two acts, including LIHPRHA's preemption provision, when examining plaintiffs' damages claims. Thus,

defendant asserts that LIHPRHA's preemption provisions are no shield to LARSO's indirect prohibition of prepayment and conversion.

LARSO specifically excepts government operated or exempted dwelling units or those subject to federal subsidization programs. LARSO defines "rental units" as:

> Housing accommodations which a government unit, agency or authority owns, operates, or manages, or which are specifically exempted from municipal rent regulation by state or federal law or administrative regulation, or as to which rent assistance is paid pursuant to 24 C.F.R. [§] 882 ("HUD Section 8 Federal Rent Subsidy Program"). This exception shall not apply once the government ownership, operation, management regulation or rental assistance is discontinued.

JX 94 (LARSO, Sec.151.02, ¶ 18(5)). LARSO, Sec. 151.04 restricts landlords' abilities to raise rents above the maximum, permitted adjusted rent, and LARSO, Sec. 151.06(C) provides for vacancy decontrol whereby the units of below-market rent control tenants, who voluntarily vacated or were evicted for default, breach, or rehabilitation/demolition of the premises, may be raised to market levels. *See also* LARSO, Sec. 151.09(A)(1), (2), (9). In the late 1980s, the Los Angeles City Council became concerned that prepayment of federally subsidized low interest loans under Sections 236 and 221(d)(3) would cause owners to raise rents to market levels, causing a serious impact on the community in the form of excessive rent burdens to tenants and "enormous and unanticipated benefits" to the owners. *Mot. of Councilwoman Ruth Galanter, 6th District* (adopted as amended 23 August 1988). The City Council endeavored to find ways in which to

capture the properties at issue within the scope of LARSO. Thus, the 1990 Amendments to LARSO were passed, the express purpose of which was to prevent owners who prepay their existing mortgage balances to HUD from charging market-level rents. Initially, as discussed in Section I.B., *supra*, the City Council's characterization of the benefits to the owners as "unanticipated" is myopic and simply absurd when viewed from the owners' position. The dispositive issue with respect to LARSO is whether the ordinance would have applied to plaintiffs upon prepayment or whether it was preempted by LIHPRHA.[14]

A. Preemption generally

The premise behind the doctrine of federal preemption, which finds it constitutional predicate in U.S. Const. art. VI, cl. 2, is that where Congress has constitutionally legislated in a field, any legislation by a state or a political subdivision of a state running counter to the federal action is superseded to the extent it is inconsistent with federal law. Generally, it is considered permissible for states to supplement the federal legislation or to enact supplemental regulations affecting the same subject matter but only to the extent such regulations do not interfere with the federal plan.

The U.S. Supreme Court has set forth three tests for determining whether the state statute is preempted by the federal law. First, "explicit preemption" is where the language of statute expressly provides, or the

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[14] The court notes plaintiffs' argument that LARSO would not have applied upon prepayment *on its own terms* (narrowly tailored as they were by the Los Angeles City Council around LIHPRHA) or as a result of the operation of "sticky vouchers" (government issued, tenant-based promises to pay market rents) and defendant's response thereto. *See JX* 94 (LARSO, Sec.151.02, ¶ 18(5)); (*R.* at 184-85, 212-13). The court concludes that these contentions need not be fully addressed, however, in view of the discussion of preemption, which is dispositive of the LARSO issue.

federal scheme is so pervasive as to foreclose any inference of room left for state supplementation, the federal act supersedes the state law. *Gade v. National Solid Wastes Mgmt. Ass'n*, 505 U.S. 88, 98, 112 S.Ct. 2374, 2383, 120 L.Ed.2d 73 (1992); *Wisconsin Public Intervenor v. Mortier*, 501 U.S. 597, 605, 111 S.Ct. 2476, 2481-82, 115 L.Ed.2d 532 (1991); *Cover v. Hydramatic Packing Co.*, 83 F.3d 1390, 1393 (Fed.Cir.1996). Second, "field preemption" is where the federal interest is deemed so dominant as to preclude supplemental state regulation, the federal act will be deemed to preempt the state regulation. *Gade*, 505 U.S. at 98-99, 112 S.Ct. at 2383-84; *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230, 67 S.Ct. 1146, 1152, 91 L.Ed. 1447 (1947); *Cover*, 83 F.3d at 1393. Arguably, neither test is applicable to the case at bar. Neither party has argued that the City of Los Angeles, a political subdivision of the State of California, is without any authority to enact housing regulations and rent control ordinances. Rather, the focus of this argument is the effect of those ordinances upon the intended functioning of the federal program. This moves the discussion to the third test for preemption, "conflict preemption."

Where state legislation or regulation presents a serious obstacle to the fulfillment of the purposes and objectives of a federal program, the state scheme must fall. *Gade*, 505 U.S. at 98, 112 S.Ct. at 2383 (quoting *Florida Lime & Avocado Growers Inc. v. Paul*, 373 U.S. 132, 142-43, 83 S.Ct. 1210, 1217-18, 10 L.Ed.2d 248 (1963)); *Cover*, 83 F.3d at 1393; *see also Board of County Supervisors of Prince William County v. United States*, 23 Cl.Ct. 205, 213-14 (1991), *aff'd in part, rev'd in part on other grounds*, and *remanded*, 48 F.3d 520 (Fed.Cir.1995). As applied to the instant case, there is a strong argument for preemption. A major facet of the federal housing programs was to permit owners to prepay their mortgages after the 20-year anniversary

date. As such, the granting of this right to property owners was tied in with the goals of development, management, and eventual, complete privatization of public housing. The expectation as of the enactment of this program and also likely indicated in later Congressional action to foreclose the prepayment option was that owners might exercise this option after 20 years and exit the federal regulatory program. Such action would permit the owners *inter alia* to raise rents to market levels or otherwise reap the benefits from any appreciation in value of the various properties once they were no longer restricted. These significant expectations and inducements are inherent to the federal scheme. Any state or municipal ordinance that materially interferes with the owners' ability to prepay, exit the federal program, convert to conventional, raise rents to market levels, or reap other financial rewards poses an immediate obstacle to the fulfillment of Congressional objectives embodied in the federal housing programs.

Two cases from the U.S. Court of Appeals for the First Circuit deal with the preemption of local rent control ordinances through HUD regulations. In *Kargman v. Sullivan*, 552 F.2d 2 (1st Cir.1977), the court held that a city rent control ordinance operated independently of the federal subsidized housing scheme and, therefore, was not automatically preempted. *Id.* at 13. With a different result, the court in *City of Boston v. Harris*, 619 F.2d 87 (1st Cir.1980) held that the city rent control ordinance directly conflicted with the HUD regulations for subsidized housing projects and was thus preempted. *Id.* at 94.

The instant case presents a materially different fact pattern from these First Circuit cases. *Harris* and *Kargman* dealt with two, distinct pieces of rental rate legislation operating concurrently. In contrast, LARSO

specifically exempts all projects under federal regulation from its operation up to the point where federal subsidization is discontinued; thus, there is no direct conflict as the City of Los Angeles has conceded that part of the field to HUD. The preemption issue in the case at bar, however, concerns an interference with the expectations and purposes of the federal scheme rather than a direct conflict. Insofar as LARSO operates to prevent the owners from receiving the financing necessary to prepay and exit the federal program, it interferes with the federal scheme. Because the Los Angeles City Council tailored LARSO so narrowly around LIHPRHA, however, there is no direct conflict because the two governmental acts never act concurrently.

B. Congressional intent to preempt

In determining whether federal law preempts state or local law, courts must give effect to the unambiguously expressed intent, purposes and objectives of Congress. *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 516, 112 S.Ct. 2608, 2617, 120 L.Ed.2d 407 (1992). Congress' original intent with respect to plaintiffs originally unfettered prepayment rights is manifested by LIHPRHA's express prohibition of any state or local law from restricting, inhibiting or otherwise interfering with the property owners' right to prepay their existing mortgage balances as of the 20 year prepayment date. LIHPRHA provides:

> § 4122. Preemption of State and local laws
>
> (a) In general. No state or political subdivision of a state may establish, continue in effect, or enforce any law or regulation that--
>
> (1) restricts or inhibits the prepayment of any mortgage described in section 229(1) [12 U.S.C.S. § 4119(1)] (or the voluntary termination

> of any insurance contract pursuant to section 229 of the National Housing Act [12 U.S.C.S. § 1715t]) on eligible low-income housing; . . .
>
> Any law, regulation, or restriction described under paragraph (1), (2), (3), or (4) shall be ineffective and any eligible low-income housing exempt from the law, regulation, or restriction, only to the extent that it violates the provisions of this subsection.

12 U.S.C. § 4122(a). Congress' original intent is further confirmed by the report of the Committee on Banking, Finance and Urban Affairs, which states that 12 U.S.C. § 4122:

> would preempt and declare null and void any state or local law, ordinance or regulation that limits an owner's right to pay off a mortgage on eligible low-income housing or, limits the occupancy, type of tenure, use or *rental charges* of such a property. The Committee wishes to emphasize that the preemption provision only applies to eligible housing, defined in the bill as projects with mortgages that are insured or assisted under the Section 221(d)(3)[ ] and Section 236 program. . . .

H.R.Rep. No. 101-559, 101st Cong., 2d Sess., at 78 (1990).

C. Preemption of LARSO

Applying the third test for whether federal law preempts state law, the focus of the court's inquiry and mode of interpretation are whether the state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Jones v. Rath Packing Co.*, 430 U.S. 519, 526, 97 S.Ct. 1305, 1310, 51 L.Ed.2d 604 (1977) (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67, 61 S.Ct. 399, 404,

85 L.Ed. 581 (1941)). This inquiry requires the court "to consider the relationship between state and federal laws as they are *interpreted and applied, not merely as they are written.*" *Jones*, 430 U.S. at 526, 97 S.Ct. at 1310 (emphasis added). Therefore, the analysis of LARSO's effect in the present case necessarily involves a consideration of how the ordinance operates as a matter of economic reality, rather than a mere examination of its text.

Plaintiffs' properties qualify as eligible low-income housing within the meaning of 12 U.S.C. § 4119 for the purposes of LIHPRHA's preemption provisions.[15] LARSO prevents affected low-income housing owners such as plaintiffs from charging market-level rents. This would have been true whether or not LIHPRHA was enacted. Without the cash flow from market rents, no lending institution will provide the plaintiffs with the financing necessary to prepay their mortgages. (*R.* at 244-45.) Far from accidentally, LARSO thus inhibits plaintiffs' ability to prepay their existing mortgage balances and to convert their properties to conventional. Moreover, although the terms of LARSO on their face take effect only after federal housing subsidization ceases, the on-going effect of LARSO is to interfere materially with the intent of the federal subsidized housing program. This interference with prepayment rights rather craftily attempts to circumvent the original intent of the federal program

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[15] Eligible low income housing is housing financed by a loan or mortgage that is "insured or held by the Secretary and bears interest at a rate determined under the proviso of section 1715*l*(d)(5) of this title" or that is "insured, assisted, or held by the Secretary or a State or State agency under section 1715z-1 of this title." 12 U.S.C. § 4119(1)(A)(ii), (iii) (1994). Plaintiffs are participants in either the Section 221(d)(3) or Section 236 federal programs, and, as such, their developments are insured by the Secretary of HUD under 12 U.S.C. § 1715z-1.

and is thus contrary to the expressed intent of Congress. *See* 12 U.S.C. §§ 4101(a), 4122. Defendant did not dispute this at trial or in its post-trial brief Rather, defendant claims that plaintiffs only argue that, but for the enactment of LIHPRHA, the property owners would have been able to prepay their mortgages. Defendant maintains that if plaintiffs wish to consider whether they could have prepaid their mortgages were it not for the government's breach, they must do so absent consideration of LIHPRHA and the preemption provision contained therein.[16] Therefore, argues defendant, plaintiffs' complete reliance on LIHPRHA's preemption provision is "without merit." Once plaintiffs start down that treacherous path, defendant contends, the die has been cast. Defendant would like to have its cake and eat it too.

The government's argument rings hollow, for even without LIHPRHA's section 4122(a) preemption provision, LARSO would nevertheless have interfered with plaintiffs' originally unfettered prepayment rights, contrary to Congressional intent. Specifically, defendant's argument is misguided for two reasons: (1) LARSO interferes with Congressional intent as embodied in the original contracts between plaintiffs,

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[16] The court notes that defendant never disputed that LARSO's prohibition of rent increases directly impacts plaintiffs' ability to prepay their existing mortgage balances and to convert the subject properties to conventional. Rather, defendant relies on the legal argument that plaintiffs cannot compare their state of affairs with and without LIHPRHA and its preemption provision. "Accordingly, [plaintiffs] cannot invoke LIHPRHA's preemption provision as a shield from the *effect of LARSO upon* prepayment and conversion of their properties to conventional rental income properties." *See Def's Post-Trial Brief* at 37-38. Indeed, this statement suggests that defendant does not dispute that LARSO interferes with plaintiffs' prepayment rights--plaintiffs' Congressionally intended prepayment rights.

HUD, and the lending institutions, irrespective of LIHPRHA; (2) plaintiffs' consideration of prepayment in the absence of LIHPRHA is for the limited purposes of this litigation, *i.e.*, quantifying their injury as a result of the government's breach. The properties at issue, as subsidized housing, all came into existence as federal program housing with the assistance or impedance of state or local laws. The moment LARSO was passed, it operated not only prospectively, but in effect it immediately sought to prohibit the owners from realizing the fruits of their bargain, *i.e.*, the ability to raise rents to market levels. Ultimately, the facts are that: LARSO conflicts with the Congressionally stated intent of the original prepayment scheme; LIHPRHA was indeed enacted; and LIHPRHA breached the contracts with plaintiffs. The government must bear the consequences of its breach through enactment of LIHPRHA, *i.e.*, federal preemption of LARSO. In measuring damages, the court takes the difference between the economic positions plaintiffs would have occupied with LIHPRHA and without LIHPRHA. Therefore, LARSO does not offset or bar plaintiffs' recovery of damages.

V. The Court Adopts Plaintiffs' Damages Model.

As the court has noted several times above, plaintiffs' damages model relies on verifiable industry data to arrive at a damages calculation, whereas defendant's damages model relies too frequently on its own expert witness' subjective judgments and limited experience. Nonetheless, the court concludes that ultimately the parties' differing damages models do not necessarily generate a substantially different damages figure, provided that several troubling features of defendant's model are rectified. Once corrected for erroneous accounting and calculatory omissions, defendant's damages model yields an amount virtually

identical to plaintiffs' model. (*R.* at 702-03.) This is further evidence to support the comprehensiveness and reliability of plaintiffs' damages model. Throughout the trial, it became apparent to the court that defendant's damages model charges plaintiffs with certain costs but fails to credit them with the attendant benefits, or vice versa. Also, defendant's damages model incorporates certain economic assumptions that have no basis in fact. With respect to some of these errors and omissions, defendant's economic expert reluctantly conceded that such treatment in the damages analysis was not economically valid.

A. Errors

Defendant's damages model contains three significant errors, which render it less comprehensive and reliable than plaintiffs' model. Debt service calculation is a critical facet of both parties' damages models. As discussed above, plaintiffs' expert, Dr. Peiser, made the conservative assumption that plaintiffs would refinance only the amount needed to pay off the existing HUD mortgage plus points on the new mortgages. This resulted in a more conservative calculation. If plaintiffs had refinanced more than needed to repay their existing loans, the economic impact of the additional proceeds from such loans must be taken into account, *i.e.*, there would be an offset of the reduction in operating cash flow and higher damages. Defendant would have the court treat the larger, proposed refinancing strictly as a cost without considering the attendant benefits. This flaw in defendant's model was recognized even by defendant's expert on cross-examination. *See supra* Section I.A.

Another error in defendant's damages model affects its treatment of HUD interest rate subsidies, payments made by HUD directly to the mortgage holders, the lending institutions rather than to the property owners,

which effectively reduced the owner's debt service on the loans to below market rates. Interest subsidy payments were never made to the owners, nor did the properties receive any income therefrom. Despite this, however, one of defendant's experts erroneously imputed these subsidies as income to plaintiffs without taking into account that the corresponding interest must then likewise be imputed to the owners. The net effect of this analytical error was to impute income to plaintiffs they never received. Indeed, defendant's expert indicated that when applied to an analogous scenario, such accounting is economically incorrect. (*R.* at 693-94.) Lastly, defendant's expert charged the entire amount of the management fee paid by the property owners to their property manager although G & K is neither owned by plaintiffs nor distributes this amount to plaintiff properties as profit. Rather, the management fee is used to maintain building operations, pay employee salaries, and cover the costs of G & K's office expenses. (*R.* at 103-04.) It seems that defendant's expert merely assumed that management fees would be utilized solely as profit rather than to cover overhead.

B. Omissions

Defendant's damages model also overlooks consideration of three economic factors. These omissions tend to reduce plaintiffs' damages under the government's economic analysis. Defendant's damages model fails to consider: (1) the impact of HUD's post-prepayment restrictions discussed *supra*, Section II; (2) the HELP Loans discussed, *supra*, Section III; and (3) the costs of converting to conventional. Conversion costs are the costs incurred when owners convert properties from HUD-restricted to market-rate status. Defendant's model does not consider the difference in conversion costs between the market-rate

and no-interest HUD scenarios. (*R.* at 678-82). The significance of considering these costs is that plaintiffs incurred a benefit from deferring payment of these expenses several years as a result of their compelled continuation in the HUD programs, during which time they were forbidden from converting to conventional. Plaintiffs' damages model subtracts HUD restricted conversion costs as of the original prepayment dates from market rate conversion costs as of the subsequent prepayment dates and attributes the difference as a benefit to plaintiffs under the HUD scenario. This is money they would have paid out but for the breach but did not have to pay until later as a result of the breach. This economic benefit to plaintiffs was not considered in defendant's income approach model even though it would have reduced defendant's calculations of plaintiffs' damages. While such accounting may prove slightly unfavorable to plaintiffs' damages figure, it lends great weight to the thoroughness, reliability, and integrity of their damages model as a whole.

C. The Expense of Processing Plans of Action

Defendant challenges the accuracy and reliability of plaintiffs' claims to the cost of processing POAs pursuant to 12 U.S.C. § 4107. These total costs of preparation and processing represent the sum of the variable costs and fixed legal/appraisal costs incurred in processing POAs under ELIHPA and LIHPRHA.[17] Defendant claims that plaintiffs are entitled to neither. The law is clear that legal expenses, whether characterized as breach damages or attorneys' fees, are only recoverable if they are the "natural and probable consequence" of defendant's breach, *Mega Constr. Co. v. United States*, 29 Fed.Cl. 396, 479 (1993), or awardable

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[17] The total costs of processing POAs for each of the subject properties is: $128,836 for Sherman; $62,669 for Independence; $141,130 for St. Andrews; and $27,122 for Pico Plaza.

to a "prevailing party" under the Equal Access to Justice Act ("EAJA"), 28 U.S.C. § 2412(d) (1985), respectively. This court and its predecessor have repeatedly held that even damages in the form of legal and consulting expenses incurred as a result of the government's breach are speculative and remote consequential damages, and as such, are not awardable. *See Kania v. United States*, 227 Ct.Cl. 458, 650 F.2d 264, 269 (1981); *Cavanagh v. United States*, 12 Cl.Ct. 715, 719 (1987); *Albemarle Bank & Trust Co. v. United States*, 12 Cl.Ct. 704, 706-07 (1987); *Mazama Timber Prods., Inc. v. United States*, 6 Cl.Ct. 87, 90 (1984); *L'Enfant Plaza Props., Inc. v. United States*, 3 Cl.Ct. 582, 594 (1983).[18] Accordingly, legal/appraisal expenses, as consequential damages, are only recoverable to the extent that they were foreseeable at the time of contract formation, not at the time of the breach. *Lucas v. United States*, 25 Cl.Ct. 298, 310 (1992). The determination of whether consequential damages were foreseeable at the time of formation such that they are the natural and probable consequence of the breach is a factual inquiry. *Smokey Bear Inc. v. United States*, 31 Fed.Cl. 805, 809 (1994).

1. Variable costs

The claimed variable costs, according to defendant, are unreasonable for several reasons. First, defendant takes issue with the numeric computation of these costs as 2% of the preservation equity for each project, *i.e.*, the difference between each property's fair market value and the existing, HUD- insured, mortgage balance. Second, defendant claims that plaintiffs have not adequately substantiated these costs and have

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[18] The legal expenses cited in these precedents dealt with the costs of litigating separate, unrelated lawsuits correlated to--but not caused by--the breach or covering the indirect costs and effects of the breach.

failed to produce any accurate written record of the costs and itemization of these services. Third, defendant argues that it is not clear whether plaintiffs actually paid for these services. Upon review of the testimony and supporting documentation entered into evidence by plaintiffs at trial, the court agrees with defendant's rejection of the variable costs. *See PX* 201-04, *Schedule B(7)*. These documents set forth a general explanation of the costs associated with processing a POA pursuant to HUD's program. For example, a June 24, 1993 memorandum found at n. 44 prepared by Boston Financial Asset Management, a division of The Boston Financial Group, explains:

> There is a complex time consuming process involved with achieving the benefits of the program. It begins with a valuation and concludes with HUD's approval and funding of a Plan of Action. To gain HUD approval, the programmatic submissions exceed the normal duties of the General Partner to conduct the affairs of the Partnership.... The consent of the Limited Partners is herewith requested for the payment of a total processing fee that will equal 2% of the Preservation Equity, with a minimum fee of $50,000 and a maximum fee of $100,000. (Preservation Equity is defined in the HUD program as market value less the HUD mortgage balance.) Thus the amount of the fee will vary with the value that HUD eventually attributes to the property.

Id. (emphasis omitted); *see also* 12 U.S.C. § 4107(b)(1). Pursuant to the agreements, Boston Financial was to receive 20% of the total processing fee--*i.e.*, 0.4% of the Preservation Equity--and this fee was to be paid for services rendered "upon closing of the transaction. *Payment of the fee [was to] thus occur at the time when*

distribution of proceeds is made to the limited partners." *Id.* (emphasis added); *see also* 12 U.S.C. § 4107(b)(1).

Plaintiffs thus claim that their decision to prepare and process their POAs came as the result of a statutory directive to do so. According to plaintiffs, the owners had no choice but to incur these costs to comply with LIHPRHA's requirements, regardless of whether plaintiffs wished to: prepay the existing mortgage balances and terminate the affordability restrictions; extend the affordability restrictions by requesting incentives; or sell the property to a buyer who would agree to maintain the affordability restrictions. *See* 12 U.S.C. § 4107(a)(1). In other words, plaintiffs argue that expenditure of these costs was the natural and inevitable result of the breach, since LIHPRHA itself mandated that plaintiffs prepare the required POAs in order to prepay their existing mortgage balances.

Even though the claimed variable costs are not attorneys' fees arising from litigation *per se*, this court and its predecessor have rejected similar consulting expenses incurred as an unforseen result of breach of contract. The court feels that these variable costs were neither within the parties' actual contemplation at the time of formation nor the direct and inevitable result of defendant's breach. Whereas plaintiffs could have foreseen that the government would not fulfill its contractual obligations in light of plaintiffs' economic expectations, plaintiffs were not coerced by defendant to submit POAs pursuant to LIHPRHA. Further, plaintiffs have not established a rational basis for the amount of variable legal expenses based upon an assigned relationship to the properties' preservation equity. The court, therefore, concludes that expenditure of these variable costs was unforeseen and remote, and as such, are not awardable as consequential

damages. Indeed, two of the four model properties have not even incurred these expenses yet. Accordingly, plaintiffs' damages figure shall be adjusted downward by the amount of variable costs.

2. Fixed Legal/Appraisal Costs

Plaintiffs also seek compensation for the fixed legal/appraisal expenses associated with the preparation and processing of their POAs. This amount is $16,000 per property, which represents a fixed $10,000 amount for legal costs and a fixed $6,000 amount for appraisal costs. Defendant challenges the amount for legal costs on two bases: (1) there is no statutory authority for an award of attorneys' fees in this context; and (2) such legal/appraisal costs constitute consequential damages, which are rarely recoverable against the United States. While it is well-settled that attorneys' fees arising from litigation may only be awarded in this court pursuant to EAJA, 28 U.S.C. § 2412(d), upon motion by the prevailing party after entry of final judgment, it is a separate issue whether legal/appraisal costs that, in part, give rise to litigation are awardable. In this case, plaintiffs claim that they had to retain legal counsel and appraisal experts to assist in the preparation and processing of their POAs to comply with LIHPRHA. Thus, claim plaintiffs, their legal/appraisal expenses flow from the breach itself rather than the litigation of the breach.

It is clear that plaintiffs' claimed fixed legal/appraisal costs are not attorneys' fees arising out of the instant or other litigation. Nevertheless, the court notes that, in fact, these fixed costs are even more speculative than the variable costs discussed above. *A fortiori*, the court looks upon *fixed* costs questionably, especially since plaintiffs have neither explained the fixed nature of these costs nor revealed how the work covered by these fixed costs differed from the work

covered by the variable costs. Nor have plaintiffs substantiated the relation of the fixed costs to the nature of the work performed. This court cannot conclude from the record, therefore, that incurrence of the fixed costs was contemplated by the parties insofar as they were the natural and probable consequence of the breach. Rather, the court concludes that expenditure of fixed legal/appraisal costs was also unforeseen at the time of contract formation and remote, and as such, are not awardable as consequential damages either. Accordingly, plaintiffs' damages figure shall also be reduced by the amount of fixed legal/appraisal expenses, $16,000 per plaintiff, used to prepare and process their POAs.

Conclusion

Plaintiffs' damages model is comprehensive, reliable, and based on objective, verifiable HUD and industry data. In contrast, defendant's economic model is subjective and plagued by admitted errors, material omissions, and incorrect assumptions. Whereas plaintiffs' damages model can easily be applied to the remaining litigation, defendant's model would almost certainly require individualized judgment calls and mire the court and the parties in 38 additional, costly evidentiary and valuation hearings for the non-model plaintiffs in this phase of the case. Accordingly, after careful consideration of the arguments, testimony, exhibits, and applicable law, the court adopts plaintiffs' damages model with the limited exceptions discussed *supra*, Section V.C., and concludes that plaintiffs are entitled to damages in the amount of $3,061,107[19] for the four model properties.

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[19] This figure represents the original amount of claimed damages ($3,420,864) less the sum of the variable and the fixed legal/appraisal costs of the four model properties ($359,757).

APPENDIX E

UNITED STATES COURT OF APPEALS
FEDERAL CIRCUIT

Nos. 97-5126

CIENEGA GARDENS, ET AL., PLAINTIFFS-APPELLEES

v.

UNITED STATES, DEFENDANT-APPELLANT.

[Decided Mar. 11, 1999]

ORDER

A combined petition for rehearing and suggestion for rehearing in banc having been filed by the APPELLEES, and a response thereto having been invited by the court and filed by the APPELLANT* and the petition for rehearing having been referred to the panel that heard the appeal, and thereafter the suggestion for rehearing in banc and response having been referred to the circuit judges who are in regular active service,

UPON CONSIDERATION THEREOF, it is

ORDERED that the petition for rehearing be, and the same hereby is, DENIED and it is further

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* Two briefs were filed by amici curiae.

ORDERED that the suggestion for rehearing in banc be, and the same hereby is, DECLINED.

The mandate of the court will issue on March 18, 1999.

For the Court,

/s/Jan Horbaly

Jan Horbaly
Clerk

Dated: March 11, 1999

Supreme Court, U.S.
FILED
AUG 9 1999
OFFICE OF THE CLERK

(2)

No. 98-1966

In the Supreme Court of the United States

SHERMAN PARK APARTMENTS, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether the enactment of legislation restricting the prepayment of certain loans guaranteed by the Department of Housing and Urban Development, and secured by mortgages on rental housing projects owned by petitioners, breached any contract between petitioners and the government.

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In the Supreme Court of the United States

No. 98-1966

SHERMAN PARK APARTMENTS, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-38a) is reported at 162 F.3d 1123. The opinions of the Court of Federal Claims (Pet. App. 39a-91a, 92a-103a, 104a-158a) are reported at 33 Fed. Cl. 196, 37 Fed. Cl. 79, and 38 Fed. Cl. 64.

JURISDICTION

The judgment of the court of appeals was entered on December 7, 1998. A petition for rehearing was denied on March 11, 1999. Pet. App. 159a-160a. The petition for a writ of certiorari was filed on June 8, 1999. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Sections 221(d)(3) and 236 of the National Housing Act, 12 U.S.C. 1715*l*(d)(3) and 1715z-1, authorize the Department of Housing and Urban Development (HUD) to insure the payment of mortgages obtained by private developers, thereby enabling private lenders to provide low-interest financing for the construction of housing for low-and moderate-income families. See Pet. App. 3a. Petitioners are owners of rental housing projects in Los Angeles, California, that were developed in the early 1970s with 40-year mortgage loans insured by HUD. See *id.* at 6a-7a.

In each of the transactions at issue in this case, one of petitioners and a private lender sought and received from HUD a commitment to provide mortgage insurance subject to various conditions, including compliance with program rules and the completion of appropriate documentation. See Pet. App. 14a-15a. At the closing of each transaction, the lender and developer entered into a deed of trust (mortgage) and a deed of trust note (mortgage note). The developer also signed a separate "regulatory agreement" with HUD, under which the developer agreed to make timely payments on the mortgage note and to observe various program rules, including limitations on tenant incomes, rental rates, and the permissible rate of return on the developer's investment in the project. In consideration of the developer's promises under the regulatory agreement, HUD endorsed the deed of trust note, thereby agreeing to insure the lender in accordance with the terms of the applicable law and regulations. *Id.* at 15a-18a.[1]

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[1] The terms of the insurance contract between HUD and the lender were set out in regulations at 24 C.F.R. Part 207, Subpart B

HUD's mortgage insurance, and a developer's regulatory agreement, were to remain in effect as long as a given loan remained outstanding. Pet. App. 4a. Prepayment of a loan would therefore terminate both the insurance and the regulatory agreement, allowing the developer to operate its project without regard to HUD's affordability restrictions. *Id.* at 4a-5a. The regulatory agreement between HUD and the developer did not address prepayment of the loan, or incorporate any other agreement on that issue. *Id.* at 19a. The only document that did address prepayment was the deed of trust note. *Id.* at 20a. The note provided, in a rider attached to the printed form of agreement, that the loan could not be prepaid without HUD approval for the first 20 years of its term, but could be prepaid without approval after that time (subject to other conditions not relevant here). *Id.* at 15a-16a.[2]

In the late 1980s, concern arose that owners of many housing projects might soon choose to prepay HUD-insured loans, potentially resulting in a shortage of low-income rental housing. Pet. App. 5a. In 1988, Congress responded by enacting the Emergency Low Income Housing Preservation Act of 1987 (ELIHPA), Pub. L. No. 100-242, Tit. II, 101 Stat. 1877 (12 U.S.C. 1715*l* note), which temporarily prohibited prepayment of

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(1970). See 24 C.F.R. 207.254(c) (1970), as incorporated by 24 C.F.R. 221.751 and 236.251 (1970).

[2] The terms of the rider reflected the prepayment policy set forth in contemporaneous HUD regulations. See 24 C.F.R. 221.524(a)(ii) and 236.30(a)(i) (1970). The Secretary of HUD explicitly reserved the right to amend those regulations (along with others relating to the mortgage insurance program), subject to the proviso that amendments would not adversely affect the interests of a "mortgagee or lender" under an existing contract or commitment. See 24 C.F.R. 221.749 and 236.249 (1970).

insured mortgages without HUD approval. *Ibid.* In 1990, Congress replaced ELIHPA with the Low-Income Housing Preservation and Resident Homeownership Act (LIHPRHA), 12 U.S.C. 4101 *et seq.* LIHPRHA extended the prohibition on prepayment without HUD approval, and authorized HUD to offer owners certain financial incentives to maintain affordability restrictions on their projects. See 12 U.S.C. 4101, 4109.[3]

2. Petitioners sued the government in the Court of Federal Claims, contending that the prepayment restrictions imposed by ELIHPA and LIHPRHA breached a contractual commitment by HUD that they could prepay their HUD-insured loans, without approval, at any time after 20 years.[4] The trial court

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[3] In 1996, Congress directed HUD to permit prepayment of insured mortgages so long as the owner agreed not to raise rents for 60 days after prepayment. See Pet. App. 6a, 114a; Housing Opportunity Program Extension Act, Pub. L. No. 104-120, § 2, 110 Stat. 834 (referring to provisions of H.R. 2099, 104th Cong., 1st Sess. (1995), as passed by the House of Representatives on Dec. 6, 1995); 141 Cong. Rec. H14112, H14113 (daily ed. Dec. 6, 1995) (relevant provisions as set out in conference report on H.R. 2099 (amendment numbered 16)); 141 Cong. Rec. H14187-H14203 (daily ed. Dec. 7, 1995) (adopting conference report). The court of appeals did not address any issue arising out of the 1996 legislation. See Pet. App. 6a.

[4] The original complaint was filed in 1994 by various plaintiffs, including petitioners Sherman Park Apartments, Independence Park Apartments, and St. Andrews Gardens. Pet. App. 6a n.3. In 1996, 21 additional plaintiffs, including petitioner Pico Plaza Apartments, joined the suit. *Id.* at 10a n.8. In addition to their contract claims, petitioners alleged uncompensated takings of their property and unlawful administrative actions by HUD. *Id.* at 6a. The Court of Federal Claims dismissed the claims based on administrative actions, and petitioners subsequently abandoned those claims. *Id.* at 7a n.4, 11a-12a & n.10. The Fifth Amendment

agreed. Pet. App. 39a-48a, 54a-65a, 91a, 98a. That court concluded that although HUD was not named as a party to the loan agreement, other than through its endorsement with respect to insurance, "when [HUD and petitioners] entered into the regulatory agreement they also intended to be mutually bound by the prepayment rules set forth in the rider to the contemporaneous deed of trust note." *Id.* at 58a, 98a.[5] After a trial to determine damages, the court awarded petitioners a total of $3,061,107 in compensation on the theory that, in the absence of ELIHPA and LIHPRHA, after 20 years petitioners would have replaced their HUD-insured loans with uninsured loans, begun to charge market rents for their properties (which would have been permitted, in the court's view, because federal law would have preempted an otherwise applicable local rent control law), and therefore earned a greater return on their investments than they were able to realize under HUD's affordability restrictions. See *id.* at 119a-150a, 158a.

3. The court of appeals reversed. Pet. App. 1a-30a. The court first noted that the Tucker Act, 28 U.S.C. 1491(a)(1), waives sovereign immunity with respect to contract claims only when a suit is based on a contract

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claims remain pending in the trial court. *Id.* at 7a n.4, 10a n.9. Only petitioners' contract claims are at issue before this Court.

[5] Two other judges of the Court of Federal Claims later declined to follow their colleague's decision in this case, instead holding, in substantially similar circumstances, that there was no privity of contract between HUD and project owners with respect to prepayment of mortgage loans. See *Greenbrier (Lake County Trust Co. No. 1391)* v. *United States*, 40 Fed. Cl. 689, 696-700 (1998), appeal pending, No. 98-5111 (Fed. Cir.); *Lurline Gardens Ltd. Housing Partnership* v. *United States*, 37 Fed. Cl. 415, 419-421 (1997).

"between the plaintiff and the government"—that is, when there is "privity of contract between the plaintiff and the United States." Pet. App. 13a (quoting *Ransom* v. *United States*, 900 F.2d 242, 244 (Fed. Cir. 1990)). Assessing the transactions at issue in this case, the court concluded that although the "regulatory agreement" between HUD and each developer was "part of the same transaction" as the loan agreement between the developer and its lender, the documents "evidence[d] separate agreements between distinct parties," and each "stands alone and is unambiguous on its face." *Id.* at 22a. The trial court had therefore "erred in importing requirements [concerning prepayment] from the deed of trust note and the accompanying rider into the regulatory agreement," when "the contract documents simply do not show privity of contract between [petitioners] and HUD with respect to a right to prepay the mortgage loans after twenty years." *Ibid.* Thus, "[b]ecause there was no privity of contract between HUD and [petitioners] with respect to prepayment of the deed of trust notes, HUD could not be liable to [petitioners] for breach of contract by reason of the enactment of ELIHPA and LIHPRHA." *Id.* at 29a.[6] The court accordingly vacated the judgment of the Court of Federal Claims and remanded the case

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[6] Senior Judge Archer dissented. Pet. App. 30a-38a. In his view, the majority failed to take adequate account of "critical factors which support the [trial court's] conclusion that the government intended and in fact did bind itself to the prepayment provisions," including "the overall purpose and nature of the transactions, the intent of the parties, the terms and conditions of HUD's Commitments for Insurance of Advances, and the references in * * * HUD's Commitments and endorsements of the Notes to specific, dated HUD regulations governing these transactions." *Id.* at 31a.

with directions to that court to enter judgment in favor of the government on the contract claims. *Ibid.*[7]

ARGUMENT

1. Petitioners renew in this Court their central argument that a contractual commitment by the government to permit prepayment of insured mortgages after 20 years should be inferred, as "the intent of the parties," by treating the various documents actually signed by any of the parties to the original transaction as "interrelated," and then "considering all of 'the documents and the surrounding facts and circumstances.'" Pet. 16; see Pet. 15-20. That argument concedes at its outset the essential basis of the decision below: No document in the transaction at issue, which involved multiple agreements among commercially sophisticated and amply represented parties (see, *e.g.*, Pet. App. 56a n.9), sets out the alleged promise by the government on which petitioners now seek to rely. See, *e.g.*, *id.* at 22a.

Petitioners' suggestion to the contrary notwithstanding, the court of appeals did not consider each document involved in the mortgage transactions "in isolation," or "refuse[] to look to the realities of the[] transactions." Pet. 16. Indeed, the court explicitly "agree[d] with the Court of Federal Claims that all of the agreements before [the court were] relevant in determining the meaning of each separate contract." Pet. App. 21a-22a. After carefully examining the transaction documents and their "interrelat[ions]" (Pet. 16), however, the court recognized that, in each transaction, separate agreements were used to set out, in unambiguous terms, the

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[7] Because its conclusion with respect to privity of contract resolved the appeal, the court of appeals did not address the government's challenges to the trial court's award of damages. Pet. App. 13a.

contractual rights and obligations to be created between HUD and the private lender, between the lender and the developer, and between HUD and the developer. See Pet. App. 14a-22a; see *id.* at 22a ("The documents evidence separate agreements between distinct parties."). Although the documents used cross-references or incorporation clauses where appropriate (see Pet. App. 20a), the regulatory agreement—the only agreement between HUD and project developers (petitioners here)—did not "mention prepayment of the mortgage loan or incorporate any agreement or provision addressing prepayment" (*id.* at 19a).[8] Given the careful structuring of the documents memorializing the transaction, there is little support for petitioners' apparent theory that each document should be read, regardless of its stated parties or terms, to create rights and obligations common to all the participants. To the contrary, as the court of appeals concluded (*id.* at 22a), "[t]he critical point is that the contract documents simply do not show privity of contract between [petitioners] and HUD with respect to a right to prepay the mortgage loans after twenty years."[9]

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[8] Indeed, "it would have been inconsistent for HUD to have entered into the regulatory agreement if the agreement fixed the prepayment rights of [petitioners], in view of the express power to amend the Section 221(d)(3) and Section 236 program regulations [including prepayment restrictions] at any time that was reserved to HUD, subject only to the caveat that *mortgagees'* interests not be adversely affected." Pet. App. 24a (emphasis by the court); see 24 C.F.R. 221.749 and 236.249 (1970).

[9] Petitioners set out at some length in their statement of facts (Pet. 2, 7-11) various statements by HUD officials and individual legislators during the congressional investigation and debate that led to the enactment of ELIHPA and LIHPRHA. See also Pet. 23-24. To the extent those statements reflect an understanding that participating developers likely expected, at the time of the

Petitioners contend that the court of appeals misinterpreted the government's obligations under the transaction documents because it "failed to appreciate" that "the regulatory agreement executed by HUD was to remain in force only while the mortgage loan remained outstanding"; that "the duration of the mortgage loan could in turn be determined only by considering the prepayment provision in Rider A to the deed of trust note"; and that, accordingly, "HUD required the prepayment provision in the * * * note *for its own benefit*, to ensure that it had the right under the regulatory agreement to require Petitioners to remain in the low-income housing program for at least 20 years" (as well as to induce petitioners to enter into the transaction in the first place). Pet. 19. That argument overlooks the fact that some special provision addressing prepayment was necessary to conform the printed

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transactions at issue, that prepayment would be allowed after 20 years—an understanding that is, in any event, directly reflected in the HUD regulations then in force—they are unremarkable, but also irrelevant for present purposes. The question is not whether HUD promulgated regulations stating that, in the absence of an amendment (see 24 C.F.R. 221.749 (1970)), prepayment would be allowed after 20 years, but whether it made a contractual promise, enforceable by petitioners against the government, that it would not revise that aspect of the mortgage insurance program to petitioners' perceived detriment. The materials petitioners cite are of little help in answering that question, which turns primarily on the intent of the parties at the time of the transaction. See Pet. App. 25a ("The after-the-fact views of various parties cannot create a contractual relationship between HUD and [petitioners] with respect to prepayment terms, where the contractual documents themselves fail to evidence such a relationship."); cf. *United States* v. *Price*, 361 U.S. 304, 313 (1960) ("[T]he views of a subsequent Congress form a hazardous basis for inferring the intent of an earlier one.").

form of mortgage note used in petitioners' transactions, which gave the borrower an essentially unlimited right of prepayment, to the more restrictive prepayment conditions applicable to these transactions under HUD regulations. Compare C.A. App. 132, 151, 165, 168 (mortgage notes) with 24 C.F.R. 221.524 (1970). Such a conforming change to the form of the loan agreement between developer and lender hardly compels the conclusion that HUD (which was not a signatory) thereby became a party to that agreement.[10]

After carefully considering the documents and circumstances involved, the court of appeals rejected petitioners' argument that HUD intended to bind itself contractually to petitioners and other housing developers on the issue of prepayment rights. Pet. App. 18a, 22a, 29a. Two judges of the Court of Federal Claims independently reached the same conclusion (before the court of appeals had rendered its decision in this case), expressly declining to follow the trial judge's decision in this case. See note 5, *supra*; see also Pet. App. 159a-160a (denying petition for rehearing and declining suggestion for rehearing en banc).[11] The Federal

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[10] Indeed, even if one assumes that the parties to the note intended the prepayment provision to benefit HUD, and to be enforceable by it against either or both of them as a matter of contract law, that would require only that HUD be viewed as an intended third-party beneficiary of the agreement—a conventional contractual status that confers rights, but generally *not* obligations, on a third party who is, by definition, otherwise "a stranger to the [agreement]" (Pet. 19). See generally Restatement (Second) of Contracts §§ 301, 304 (1981).

[11] The decision below is consistent with the decisions in other cases that have rejected contract claims arising out of transactions under the National Housing Act. See *Aetna Cas. & Sur. Co.* v. *United States*, 655 F.2d 1047, 1052-1054 (Ct. Cl. 1981) (HUD's acts in insuring loan under Section 236 of the Act, 12 U.S.C. 1715z-1, to

Circuit's resolution of that fact-bound controversy, with respect to a matter within its core jurisdiction, does not warrant further review by this Court.

2. Petitioners argue (Pet. 20-25) that the decision below conflicts with this Court's decision in *United States* v. *Winstar Corp.*, 518 U.S. 839 (1996), aff'g 64 F.3d 1531 (Fed. Cir. 1995). The court of appeals properly rejected that contention. Pet. App. 27a-29a. In *Winstar*, the plaintiffs and federal regulators had entered into express contracts providing for government assistance in the acquisition of three thrifts. See 518 U.S. at 858, 861-868. The plaintiffs alleged that those contracts included terms dealing with the "regulatory treatment of supervisory goodwill and capital credits." *Id.* at 860. Although the central agreements did not address those issues, each explicitly incorporated certain other materials, and this Court accepted the Federal Circuit's conclusion that those materials included regulatory documents permitting the accounting treatments at issue. See *id.* at 860-868; 64 F.3d at 1540-1544.

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construct a low-income housing project, including its intimate involvement in all phases of the project, did not create privity of contract between HUD and construction contractor); *Brookside Ltd. Partnership* v. *United States*, 231 Ct. Cl. 944, 948 (1982) (owner of housing project with mortgage loan insured under Section 221(d)(4) of the Act, 12 U.S.C. 1715*l*(d)(4), did not have contractual relationship with HUD where owner and HUD were not both parties to any written agreements owner claimed were evidence of contract between them), cert. denied, 459 U.S. 1204 (1983); *H.A. Ekelin & Assocs.* v. *United States*, 225 Ct. Cl. 561, 563-564 (1980) (HUD's approval of loan for insurance under Section 231 of the Act, 12 U.S.C. 1715v, did not create privity of contract between HUD and alleged third-party beneficiary of loan agreement).

Petitioners argue that in deciding this case the Federal Circuit "fundamentally misread" its own prior decision in *Winstar*, and used an "approach" to contractual interpretation "flatly inconsistent" with that endorsed by this Court in that case. Pet. 20-21. Petitioners assert that the relationship between the regulatory agreement and the deed of trust note in this case is akin to the relationship between the instruments that contained the integration clauses and the various documents permitting the accounting treatment at issue in the thrift merger transactions in *Winstar*. Pet. 21. But, as the court of appeals noted, "[t]he plaintiffs in *Winstar* had contracts with integration clauses that expressly incorporated contemporaneous documents that allowed them to use supervisory goodwill," whereas the regulatory agreements in petitioners' case "do not address prepayment and do not contain integration clauses that incorporate any document addressing prepayment." Pet. App. 28a.[12]

Petitioners' real complaint is that, after applying settled precepts of contract interpretation to different facts, the court of appeals in this case reached a

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[12] Petitioners also argue that, although the documents containing the integration clauses were relevant in *Winstar*, this Court would have reached the same result absent the integration clauses, based upon "the overall facts and circumstances" of those transactions. Pet. 22-23. However, in *Winstar*, this Court only stated that, to the extent the integration clauses were *ambiguous*, the "realities" of the transaction "favored" reading those documents as contractual commitments. 518 U.S. at 863. Similarly, while the Federal Circuit in *Winstar* noted that its interpretation of the integration clauses was "supported" by other evidence and by the circumstances surrounding the transactions, that court did *not* hold that it would have reached the same result if the contracts had not contained the integration clauses.

different *conclusion* from the one it reached in *Winstar*. That circumstance, however, is not a basis for review by this Court. Pet. App. 28a.

3. Finally, petitioners contend (Pet. 25-26) that the mortgage insurance commitment issued by HUD to petitioners and their lenders "incorporat[ed] the regulations *then in effect* into [HUD's] offer to the developers," and that HUD thereby "relinquished its right to change the terms of the contract by amending those regulations."[13] That argument, which petitioner raised for the first time in the court of appeals, is without merit.

To begin with, it is far from clear that the "Regulations" to which the insurance commitment refers include the regulatory prepayment provisions on which petitioners rely. The commitment was concerned with the conditions upon which HUD would insure a loan, not the particular terms of the loan so insured; and it would therefore be most natural to read the commitment to refer to the specific regulations that prescribed (indeed, constituted) the insurance contract, between HUD and the lender, that was brought into force by HUD's endorsement of a mortgage note. See 24 C.F.R. 207.254(c) (1970) ("From the date of initial endorsement, [HUD] and the mortgagee or lender shall be bound by the provisions of this subpart to the same extent as if they had executed a contract including the provisions of this subpart and the applicable sections of

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[13] The insurance commitments stated that HUD would "endorse for insurance under the provisions of Section [221(d)(3) or 236] of the National Housing Act, and the Regulations thereunder now in effect, a mortgage note in the amount of [a stated amount], to be secured by a mortgage, on [stated] property." C.A. App. 122, 142.

the Act."). Those regulations were incorporated by reference, for purposes of the programs at issue here, by 24 C.F.R. 221.751 and 236.251 (1970), which adopted (with some exceptions) the regulations governing a similar program, set out at 24 C.F.R. 207.251-207.499 (1970). They did not include the prepayment rules applicable to the programs at issue, which appeared at 24 C.F.R. 221.524(a)(ii) and 236.30(a) (1970). Compare 24 C.F.R. 207.14 (1970) (setting out different prepayment rule for the program from which the terms of the insurance contract, but not other provisions, were borrowed for purposes of the programs at issue); see also *Lurline Gardens Limited Housing Partnership* v. *United States*, 37 Fed. Cl. 415, 420 n.7 (1997).

In any event, even if the insurance commitment's reference to regulations "now in effect" were read to embrace all regulations applicable to the relevant statutory program, petitioners' attempt to infer a contract guaranteeing them the perceived benefit of those provisions would still fail. If the reference to regulations in HUD's commitment included the prepayment regulations, then it also included the regulations specifying the effect of regulatory amendments, which were included in the same subpart as the prepayment regulations. The amendment regulations provided that any regulation in that subpart might be "amended * * * at any time and from time to time, in whole or in part," subject to the proviso that such amendments should not "adversely affect the interests of a *mortgagee or lender* under the contract of insurance on any mortgage or loan already insured." 24 C.F.R. 221.749 and 236.249 (1970) (emphasis added). Thus, if the commitment included any promise concerning changes in the prepayment (or similar) regulations, it was one made expressly to petitioners' *lenders* (who were the

primary counterparties to the commitment), not to petitioners. Indeed, as the court of appeals observed (Pet. App. 24a), it would have been quite inconsistent for HUD to limit any protection against regulatory changes so carefully to "mortgagee[s] or lender[s]" when drafting the regulations themselves, but then to enter into contracts extending the same protection to developer mortgagors. Analysis of the regulations in effect at the time of the transactions here thus cuts against, rather than in favor of, petitioners' contractual argument.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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In the Supreme Court of the United States

SHERMAN PARK APARTMENTS, ET AL.,
PETITIONERS,
v.
UNITED STATES

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

REPLY BRIEF FOR PETITIONERS

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REPLY BRIEF FOR PETITIONERS

Although the United States seeks for purposes of certiorari to characterize the petition as raising a mere "fact-bound controversy," Opp. 11, it does not seriously dispute the enormous impact of the Federal Circuit's decision. The government does not deny that the documents at issue in this case are typical of those in hundreds of identified transactions nationwide, which guaranteed the developers who provided this country's low-income housing the unfettered right to exit the program after 20 years. The government also does not dispute that, if not reversed, the Federal Circuit's decision will deny recovery to hundreds of plaintiffs who, like the plaintiffs in *United States v. Winstar Corp.*, 518 U.S. 839 (1996), agreed to assist in the government's efforts to rescue the failing savings and loan industry.

The decision below will have these and other far-reaching effects because, contrary to the government's current litigating position before this Court, this case raises fundamental questions regarding the approach that courts should take in construing complex government contracts; questions that, depending on the answer, could permit the government to shift the costs of several multi-billion dollar public programs to private parties who contracted with the United States under the mistaken impression that the government would keep its word.

The government contests none of this. Indeed, the government does not even dispute that it promised petitioners that they could prepay their mortgage loans after 20 years without HUD approval. Rather, the government seeks to evade *contractual* liability on the ground that its structured the transaction in a way that relieves it of the responsibility of keeping its promise. The government's analysis suffers from the same fatal

flaw as that of the Federal Circuit majority: Like the majority, the government views each of the relevant documents of the transaction as they "stand[] alone," instead of viewing them as part of an integrated whole. Pet. App. 22a.

1. The government concedes, as it must, that these housing transactions involved an agreement between plaintiffs and HUD and that one of the documents integral to each transaction — the deed of trust note — expressly provided that "the loan could not be prepaid without HUD approval for the first 20 years, but could be prepaid without approval after that time." Opp. 3.[1] The government does not dispute, moreover, that this prepayment provision allocated rights between the government and petitioners. *See* Pet. App. 57a-58a. The government argues, however, that it is not contractually responsible for the prepayment promise made to petitioners because it was not formally named as a party to the note. Absent HUD's signature, the government insists that the note must be viewed as a "separate agreement[]" solely between petitioners and their private lenders. Opp. 7-8.

The government's argument merely repeats the fundamental error committed by the Federal Circuit majority: it views each of the transactional documents as relevant only in "determining the meaning *of each separate contract*," *id.* (quoting Pet. App. 21a-22a) (emphasis added), and refuses to interpret the documents together, as an integrated whole, to

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[1] The government's string cite showing an absence of privity in other cases brought under the National Housing Act is inapposite. Opp. 10 n.11. In those cases, the developer had not entered into any transaction with HUD. In this case, it is undisputed that petitioners and HUD are in privity of contract. The only issue here is the terms of the contract.

determine the intent of the parties.[2] As the Court of Federal Claims correctly observed, the parties' intent in a complex transaction of this sort can be determined only "by examining all of the documents involved in the transaction and focusing on the substance of the prepayment terms rather than only their location." Pet. App. 120a n.10.[3]

The government has never before offered any reason why the petitioners and their private lenders — the only parties, according to the government, who are contractually bound by the prepayment provision in the note — would have bothered to negotiate that provision between themselves, as it allocates rights and obligations predominantly between the government and petitioners. Now, for the first time, the government suggests that the prepayment provision was inserted in the note because it was "necessary" to conform the note to HUD's regulations governing prepayment. Opp. 9-10. This suggestion makes no sense. HUD's regulations would have prevented prepayment during the first 20 years, regardless of the language of the note's prepayment provision. Moreover, if the lender and petitioners had intended

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[2] Restatement (Second) of Contracts § 202(2) ("all writings that are part of the same transaction are interpreted together"). *See also, e.g., Joy v. City of St. Louis*, 138 U.S. 1, 38 (1891); *Dakota Gasification Co. v. Natural Gas Pipeline Co. of America*, 964 F.2d 732, 735 (8th Cir. 1992).

[3] Contrary to the government's argument, Opp. 8, recognizing, based on the substance of the text, that the note contains an agreement between the government and petitioners regarding prepayment is not equivalent to saying that all of the "rights and obligations" in each of the documents are "common to all the participants." As the Court of Federal Claims observed, the text of Rider A to the note "gave the lender no right whatsoever to interfere with an owner's plan to prepay. The rider gave that power only to HUD." Pet. App. 57a. In contrast, provisions in the documents that allocate rights and obligations solely between the developer and the lender would not contractually bind HUD.

merely to acknowledge that the note would be governed by HUD's regulations, they could have inserted specific language to that effect, rather than language that contractually guaranteed petitioners particular prepayment rights. *See, e.g.*, Fed. Cir. J.A. 139 (provision of regulatory agreement requiring petitioners to comply with federal anti-discrimination statutes). Contrary to the government's *post hoc* rationale, by its plain terms, the prepayment provision in the note was inserted to signify the *government's* contractual obligation to petitioners to allow unfettered prepayment after 20 years.[4]

The government acknowledges that it received a benefit from the prepayment provision in the deed of trust note, but insists that, as a third-party beneficiary, it cannot have undertaken any corresponding obligations. Opp. 10 n.10. This argument is half right. The government surely did receive a benefit from the prepayment provision, which required the developers to maintain their properties as low-income housing for 20 years. But the provision provided the developers a benefit as well — the right to prepay their mortgage loans after 20 years and exit the low-income housing programs. Contrary to the government's suggestion, HUD was a party, not merely a third party, to the prepayment agreement, and as such, the benefits it derived and obligations it undertook were flip sides of the same coin.

Despite the government's protests, the simple truth is that it was no "stranger to the agreement." Opp. 10 n.10 (brackets omitted) (quoting Pet. 19). As

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[4] As *amici* observe, the government's prepayment promise probably was placed as a rider to the deed of trust note because that was the most logical location for it to be placed. Brief of *Amici Curiae* Institute for Responsible Housing Preservation *et al.* (*Amici* Br.) at 16-17.

thoroughly documented by *amici*, HUD exercised complete control over the preparation of all of the documents, including the deed of trust note and the regulatory agreement.[5] The government should not now — after it has received the entire benefit of its bargain — be permitted to escape its contractual responsibilities by suggesting cynically that petitioners and their lenders included the prepayment provision as an agreement solely between themselves.

To the extent the documents leave any doubt about the parties' intent, it is resolved by HUD's unequivocal admissions that it made a contractual commitment to the developers that it would permit them to prepay their mortgage loans and exit the low-income housing programs.[6] The government attempts to sidestep those admissions in a footnote, asserting that they are "little help in answering [the] question" of whether HUD "made a contractual promise" on the issue of prepayment rights. Opp. 9 n.9. The parties' views on the meaning of a contract are entitled to great weight, however, even if those views are expressed after the contract has been signed.[7]

Indeed, Members of Congress fully understood when they enacted the Emergency Low-Income Housing Preservation Act of 1987 (ELIHPA), Pub. L.

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[5] *See, e.g., Amici* Br. at 10-12.

[6] *See* Pet. 7-8 (Secretary Kemp objecting to an abrogation of "the contract that we entered into"); *id.* (R. Hunter Cushing, the Deputy Assistant for HUD's Multifamily Housing Programs, testifying that "there was a contractual relationship between the Federal Government and private owners that was negotiated at that time [and] that cannot be changed").

[7] *See, e.g., Chicago v. Sheldon*, 76 U.S. 50, 54 (1870) (holding that "the practical interpretation by the parties themselves is entitled to great, if not controlling, influence"); *see also* Restatement (Second) of Contracts § 201(1) (1981) ("Where the parties have attached the same meaning to a promise or agreement or a term thereof, it is interpreted in accordance with that meaning").

No. 100-242, tit. II, 101 Stat. 1877 (1988), and the Low-Income Housing Preservation and Resident Homeownership Act of 1990 (LIHPRHA), Pub. L. No. 101-625, tit. VI, 104 Stat. 4249, that the statutory abrogation of the developers' prepayment rights violated the government's *contractual* commitments. *See* Pet. 2, 6-11. The government's contention that the Members' statements merely "reflect" what developers "likely expected" based on HUD's prepayment regulations (Opp. 8 n.9) ignores the explicit acknowledgement by both supporters and opponents of ELIHPA and LIHPRHA that the enactment of those statutes would breach a contractual promise between the government and developers. Pet. 2, 6-11. While these admissions may be inconvenient to the government's current litigating position, they reflect what the parties understood for 20 years to be the nature of their deal, and they should not be ignored.

2. The government's attempt to distinguish this case from *United States v. Winstar Corp.*, 518 U.S. 839 (1996), is wholly unpersuasive. In *Winstar*, the government's position, like its position in this case, was that its promise of favorable regulatory treatment "simply reflect[ed] statements of then-current federal regulatory policy rather than contractual undertakings." *Id.* at 862 (plurality opinion). Indeed, that essentially remains the government's position with respect to all *Winstar*-type plaintiffs that do not have the government's promise of favorable regulatory treatment "expressly incorporated" (Opp. 12 (quoting Pet. App. 28a)) into a document to which the government was formally party. *See California Fed. Bank v. United States*, 39 Fed. Cl. 753, 772-74 (1997). *Winstar*, however, was not so limited.

To begin with, the promise of favorable regulatory treatment in *Winstar* was not "expressly incorporated"

into the plaintiffs' contracts with the government. Opp. 12 (quoting Pet. App. 28a). Rather, the relevant provision merely stated that certain contemporaneous documents — including those containing the government's promise — were not excluded by the Supervisory Agreement's integration clause.[8] The exceptions from the integration clause were considered part of the contract as a matter of negative implication. *Id.*; *see also id.* at 846 (plurality opinion). Here, other considerations — including the interrelationship between the petitioners' obligations under the regulatory agreement and their prepayment rights under the deed of trust note — similarly make clear that the government's promise to permit unfettered prepayment after 20 years was not merely "then-current federal policy" but rather part of the government's "contractual undertaking[]." *See id.* at 862 (plurality opinion).

The government is also mistaken in disputing that this Court would have reached the same result in *Winstar* absent the integration clause by examining the underlying "realities' of the transaction." Opp. 12 n.12. In *Winstar*, the plurality stated that "[t]o the extent that the integration clause leaves any ambiguity, . . . the realities of the transaction favored reading those documents as contractual commitments." 518 U.S. at 863. Contrary to the government's argument (Opp. 12 n.12), nothing in this statement implies that the plurality considered the "realities of the transaction" because the integration clause was ambiguous. Rather, the plurality independently examined the "realities of

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[8] 518 U.S. at 862 (plurality opinion) (integration clause stated that "[t]his Agreement . . . constitutes the entire agreement between the parties thereto and supercedes all prior agreements . . . excepting only the Agreement of Merger and any resolutions or letters issued contemporaneously herewith").

the transaction" to confirm the conclusion it reached by examining the integration clause.[9] *Winstar* provides no support for the government's attempt to limit consideration of the realities of the transaction in this case.

3. The government concedes that the "commitment issued by HUD to petitioners and their lenders 'incorporated the regulations *then in effect* into HUD's offer to the developers.'" Opp. 13 (internal brackets omitted) (quoting Pet. 25-26). It argues, however, that the regulations that were incorporated did not include the regulation granting petitioners the right to prepay their mortgages without HUD approval after 20 years. *Id.* The government is fundamentally mistaken.

The commitment expressly provided that HUD would extend mortgage insurance under Section 221(d)(3) or 236 of the National Housing Act (NHA) and the "Regulations *thereunder* now in effect." Pet. App. 37a (emphasis added) (emphasis in original omitted). *See also* Fed. Cir. J.A. 122, 142. This language, by its terms, includes all of the regulations promulgated under the applicable section. The regulations promulgated under Section 221(d)(3) include all of 24 C.F.R. Part 221, Subpart C and D (1970), including the prepayment regulation. 24 C.F.R. § 221.524 (1970). The regulations promulgated under Section 236 include all of 24 C.F.R. Part 236, including the prepayment regulation. 24 C.F.R. § 236.30 (1970). Thus, the express

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[9] The plurality's immediate citation to the Restatement (Second) of Contracts § 202(1) eliminates any doubt. 518 U.S. at 863. Comment a of that section explicitly provides that the "rules in this Section [202] are applicable to all manifestations of intention and to all transactions" and that "[t]hey do not depend upon any determination that there is an ambiguity." And comment c makes clear that "[e]ven language which is otherwise explicit may be read with a modification needed to make it consistent with" the principal purpose of the parties.

terms of the commitment incorporated the applicable prepayment regulation for each program.

The government mischaracterizes the regulations when it argues that the insurance contract did not include the prepayment regulations. Opp. 13-14. HUD's regulations provided that the "contract of insurance" "includes the terms, conditions and provisions of this *part*." 24 C.F.R. § 207.251 (1970) (emphasis added). That definition was incorporated by reference into Parts 221 and 236. 24 C.F.R. §§ 221.751, 236.251. Thus, the provisions of Parts 221 and 236, including the prepayment regulations, comprised the contract of insurance, and the provisions of Parts 221 and 236, including the prepayment regulations, were incorporated by reference into the commitment.

The government also relies heavily on a regulatory provision reserving HUD's right to amend the regulations. Opp. 8 n.8, 14; 24 C.F.R. §§ 221.749, 236.249 (1970). The government, however, knows full well that it cannot reserve the unfettered right to alter or repudiate its contractual obligations without paying the consequences for the breach. It has long been settled that the right to amend "is not unlimited and cannot be exerted to defeat the purpose [of the contract] . . . or arbitrarily to make alterations that are inconsistent with the scope and object of the [contract] or to destroy or impair any vested property right."[10] Any alternative rule would render the government's promises illusory, since later actions by Congress could, at any time, undo the underlying *quid pro quo* that

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[10] *See, e.g., Phillips Petroleum Co. v. Jenkins*, 297 U.S. 629, 634-35 (1936); *Sinking Fund Cases*, 99 U.S. 700, 720-21 (1878); Restatement (Second) of Contracts § 2 cmt. e (stating that illusory promise is formed "[e]ven if a present intention is manifested, [where] the reservation of an option to change that intention means that there can be no promisee who is justified in an expectation of performance").

formed the basis for a contract. *See Winstar*, 518 U.S. at 921 (Scalia, J., concurring). The government's reservation of a right to amend its regulations cannot be stretched so far as to excuse the government's unilateral cancellation of petitioners' contractual rights.

CONCLUSION

More than 100 years ago, Justice Bradley observed that legislation by Congress abrogating the terms of this nation's contractual commitments

> is well calculated to excite alarm. It has the effect of announcing to the world, and giving it to be understood, that this Government does not consider itself bound by its engagements. It sets the example of repudiation of government obligations. It strikes a blow at the public credit. It asserts the principle that might makes right. It saps the foundation of public morality.

Sinking Fund Cases, 99 U.S. at 750 (Bradley, J., dissenting). Though illegitimate, this power is politically attractive. Here, Representative Kennedy argued that Congress should not let "some fine print allowing prepayment" interfere with the government's responsibility to house low-income tenants.[11] Repudiating that fine print was the sovereign's prerogative. It is the courts' duty, however, to hold the government liable for the breach. Failure to do so will encourage Congress, for short term advantage, to ignore the nation's contractual commitments.

The petition for a writ of certiorari should be granted.

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[11] *Preservation and the Loss of Subsidized Housing Stock: Hearing Before the Subcomm. on Housing and Community Development of the House Comm. on Banking, Finance and Urban Affairs*, 101st Cong., 2d Sess. 6 (1990).

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IN THE

Supreme Court of the United States

SHERMAN PARK APARTMENTS, *et al.*,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF OF *AMICI CURIAE* INSTITUTE FOR RESPONSIBLE HOUSING PRESERVATION, INSTITUTE FOR REAL ESTATE MANAGEMENT, NATIONAL AFFORDABLE HOUSING MANAGEMENT ASSOCIATION, NATIONAL ASSOCIATION OF HOME BUILDERS, NATIONAL LEASED HOUSING ASSOCIATION, AND NATIONAL MULTI HOUSING COUNCIL IN SUPPORT OF PETITIONERS

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INTEREST OF THE *AMICI CURIAE*

The *Amici Curiae* — the Institute for Responsible Housing Preservation, the Institute for Real Estate Management, the National Affordable Housing Management Association, the National Association of Home Builders, the National Leased Housing Association and the National Multi Housing Council (jointly, the "Amici") — represent a diverse group of owners, managers, investors and other persons deeply involved in affordable housing programs created pursuant to Section 221(d)(3) of the National Housing Act (the "NHA"), Pub. L. No. 83-560, 68 Stat. 590, 599 (1954), as amended by Pub. L. No. 87-70, 75 Stat. 149 (1961) (the "Section 221(d)(3) Program"), and Section 236 of the NHA, Pub. L. No. 90-448, § 201(a), 82 Stat. 476, 498-99 (1968) (the "Section 236 Program") (the Section 221(d)(3) Program and the Section 236 Program are referred to jointly herein as the "Programs").[1] The specific interest of each of the Amici is as follows:

1. The *Institute for Responsible Housing Preservation* ("IRHP") was organized by owners and managers of projects that participated in the Programs, to represent their interests in legislation, and in related administrative matters before the U.S. Department of Housing and Urban Development ("HUD") addressing prepayment of the mortgages on those projects.

2. The *Institute Of Real Estate Management* ("IREM") educates real estate managers, certifies the competence and professionalism of individuals and organizations engaged in real estate management, serves as an advocate on issues

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1. Pursuant to Rule 37 of the Rules of the Court, Petitioners and Respondent have consented to the filing of this brief and their consent letters are filed herewith. Counsel for a party did not author this brief in whole or in part, and no person or entity, other than the Amici, have made a monetary contribution to the preparation or filing of this brief. One or more of the Petitioners may be a member of one or more of the Amici.

affecting the industry, and enhances and supports its members' professional competence so they can better identify and meet the needs of those who use their services. IREM was established in 1933 and has 10,000 members across the country. Like other Amici, a number of IREM members are involved in the finance, development and management of affordable housing, including the Programs.

3. The *National Affordable Housing Management Association* ("NAHMA") was established in 1989 as a national professional association representing managers of government-assisted housing. NAHMA members presently manage more than half of the nation's privately held stock under the Programs and other Federal housing programs.

4. The *National Association of Home Builders* ("NAHB") is a leading voice in America's shelter industry. NAHB was established more than 50 years ago and represents 197,000 member firms engaged in all aspects of single family and multifamily real estate development, construction and management. Hundreds of NAHB multifamily members nationwide representing thousands of units across the country have long participated in the federal mortgage insurance programs and have actively supported their continuance.

5. The *National Leased Housing Association* ("NLHA") with 600 members nationwide was founded in 1972 as the Section 23 Leased Housing Association (Section 23 was the predecessor program to Section 8). NLHA has been deeply involved in the Programs ever since. Its members consist of private owners who participate in the Programs.

6. The *National Multi Housing Council* ("NMHC"), which was founded in 1978, represents over 700 of the apartment industry's largest and most prominent firms. Like other Amici, a number of NMHC members across the country are involved in the finance, development and management of affordable housing, and many participate in the Programs.

Like each of the Petitioners here, the Amici firmly believe that a contract exists between the Federal government and each of the owners of affordable housing projects that participate in the Programs. As explained in more detail below, the government has breached a critical part of this contract which permitted owners to prepay their insured mortgages after twenty years. The Amici submit this brief to document the nature of the contractual relationship between the Federal government and each of the owners that participated in the Programs.

SUMMARY OF ARGUMENT

1. The Petitioners and the Amici firmly believe that a contract exists between HUD and owners participating in the Programs allowing the owners to prepay their insured mortgages after twenty years. The nature of that contractual commitment can only be understood by a thorough examination of the documents that created that contract and the entire mortgage insurance process, which provides essential factual context.

2. Searching for an answer to the enduring problem of providing affordable housing to lower income families, Congress has taken several approaches. The Programs are among its most successful experiments.

Although they varied in their specifics, both of the Programs attempted to alter the economics of the multifamily real estate market to encourage the development of affordable housing. The cornerstones of the Programs were Federal insurance of the project mortgages which allowed lenders to charge lower interest rates and then further subsidization of these rates, down to 1% or 3%. The resulting savings allowed owners to charge lower rents, thereby making thousands of units of new, high quality housing affordable for lower income families. The mortgage documents, endorsed by HUD, provided that owners could prepay their mortgages and thereby terminate restrictions on rents and tenant income,

on the twentieth anniversary of HUD's final endorsement of the mortgage.

3. To participate in the Programs, owners had to complete a long and complicated process, every step of which was completely designed and controlled by HUD. All of the documents were originated by HUD, and HUD oversaw all aspects of a proposed development — from the architectural design to financing and marketing matters. Indeed, since it was Federal money, not the money of the lender, that was ultimately at stake, HUD functioned essentially as the underwriter of these loans.

The decisions by Judge Robinson of the Court of Federal Claims, *Cienega Gardens v. United States*, 33 Fed. Cl. 196 (1995) and 37 Fed. Cl. 79 (1996), carefully analyzed these documents and the operation of the Programs and properly concluded that a contract existed between HUD and the owners participating in the Programs that allowed the owners to prepay those contracts after twenty years. The lower court found that Congress breached those contracts when it enacted the Emergency Low Income Housing Preservation Act of 1987, Pub. L. No. 100-242, tit. II, 101 Stat. 1877 (1988) ("ELIPHA") and the Low Income Housing Preservation and Resident Homeownership Act of 1990, Pub. L. No. 101-625, tit. VI, 104 Stat. 4249 (1990) ("LIHPRHA"), both of which effectively barred prepayment. As the lower court realized, each of the relevant documents had to be construed together to understand the true intention of the parties. So construed, there was no question that the Federal government made a solemn promise to participating owners that they could prepay after twenty years.

4. In violation of both the standard rules of contract interpretation and, more importantly, the intention of the parties demonstrated by the history of the mortgage insurance process, the Court of Appeals for the Federal Circuit concluded that no such contract existed. *Cienega Gardens v.*

United States, 162 F.3d 1123 (Fed. Cir. 1998). The central flaw of the appellate court's analysis is its disregard for the inherent interrelation between the documents pursuant to which owners received mortgage insurance. Only by turning its back to the actual history of the mortgage insurance process could the court reach such a conclusion that conflicts with the contemporaneous understanding of all of the parties and the historical context in which they acted.

5. This brief describes in detail the mortgage insurance process that the Programs employed. It demonstrates that HUD controlled the process entirely and dictated the terms of all the relevant documents. Most importantly, it shows that at all relevant times — up to and including the date of enactment of both ELIPHA and LIHPRHA — all of the parties concurred that a contract existed between the Federal government and participating owners, allowing them to prepay their mortgages after twenty years. The Court should grant the petition here in order to assure that a large group of persons, persuaded to assist in an ambitious program for housing the nation's poor, are not denied the rights that the Federal government by contract is bound to observe.

ARGUMENT

> Although plaintiffs or their assignors *did enter into contracts with HUD in 1966 and 1968* respectively, those contracts were subject to amendment by subsequent legislation as needed for the public good.

Brief of United States at 24, *Thetford Properties IV Limited Partnership v. U.S. Department of Housing and Urban Development*, 907 F.2d 445 (4th Cir. 1990) (emphasis added).[2] In its brief filed in 1990 in a separate case involving

2. Brief of Amici Curiae In Support Of Petition For Rehearing And Suggestion Of Rehearing In Banc, Appendix at iii; *Cienega Gardens v. United States*, 162 F.3d 1123 (Fed. Cir. 1998) (Nos. 97-5126,-5134). Subsequent references to documents found in the Appendix are cited as "App. [page number]."

the rights of owners under ELIPHA, the government thus candidly acknowledged what the housing community, HUD and Congress understood from the start of the Programs: HUD was a party to a contract that allowed the owners to prepay their mortgages after 20 years.

The government has since taken a 180° turn and now maintains — *only after the present dispute arose* — there never was such a contract. Fortunately, there is ample history that documents the contemporaneous understanding of the parties from the earliest days of the Programs. The brief will allow the Court to walk through, from a contemporary perspective, the negotiation process that led to the contractual arrangement between the parties. Without question, the government's position in *Thetford* accurately states the understanding of the parties throughout the life of the Programs: HUD and the owners indeed intended to enter into a contract that allowed the owners to prepay after 20 years.

I. THE HISTORY OF THE PROGRAMS DEMONSTRATES THAT HUD PROMISED TO ALLOW PREPAYMENT AFTER TWENTY YEARS

A. Applicable Rules of Contract Construction Require the Court to Examine the Facts, the Documents and the Parties' Statements to Determine Their Intent.

As the Petition makes clear (Petition at i), the first question here is whether the Federal Circuit correctly applied traditional principles of contract interpretation. This question inevitably involves the construction of contractual language to determine the parties' intent, a matter of law that is committed to the court's consideration. *Alaska American Lumber Co., Inc. v. United States*, 25 Cl. Ct. 518, 527 (1992).

In construing contracts, courts are guided by several rules of construction directly applicable here. First, as the Court of Appeals for the Federal Circuit has previously observed, "[w]hether a legally enforceable contract has been formed

by a meeting of the minds depends upon *the totality of the factual circumstances*." *Texas Instruments, Inc. v. United States*, 922 F.2d 810, 815 (Fed. Cir. 1990) (emphasis added). As the Court of Federal Claims explains, "the language of the contract must be given the meaning that would be derived from the contract by a 'reasonably intelligent person acquainted with the contemporaneous circumstances.' " *Alaskan American Lumber*, 25 Cl. Ct. at 527, *quoting Hol-Gar Mfg. Corp. v. United States*, 351 F.2d 972, 973 (Cl. Ct. 1965). These circumstances are especially important, because "[i]n resolving ambiguity in a contract it is proper to look at the past conduct of the parties." *Tibshraeny Brothers Construction, Inc. v. United States*, 6 Cl. Ct. 463, 470 (1984). As this brief will show, the "totality of circumstances" demonstrates that HUD controlled all aspects of the mortgage insurance process, drafting all the critical documents and providing critical approvals. The 20-year prepayment provision was central to this process and was understood by all participants to be part of the government's promise. *See* pp. 8-13, below.

Second, the documents that surround the government's promise must be considered as a whole and given the meaning the parties intended. When the mortgage insurance process is understood, it will become clear that the Regulatory Agreement, the commitment, and the endorsed deed of trust constitute components of a tightly integrated process. The appellate court erred in attempting to separate documents that the parties understood to be integrated and thus failed to give credence to the parties' obvious intent. *See* pp. 13-17, below.

Finally, the Court should consider the contemporaneous statements of the parties, before a dispute arose. In their own statements, made in contemporaneous regulations and in later declarations, the parties underscore that they understood the promise made by HUD to allow prepayment after twenty years. *See* pp. 17-20.

B. The History of the Mortgage Insurance Process Demonstrates the True Intent of the Parties.

The appellate court failed to examine the lengthy process that owners seeking mortgage insurance had to pursue in order to obtain HUD's endorsement. The omission was serious, because, fully understood, that process demonstrates that HUD was the central player, making all the key decisions, dictating the terms of the principal documents and enforcing the process which owners had to follow. By failing to examine this process, the appellate court ignored the "totality of the factual circumstances" that, the Federal Circuit has explained, must be understood to realize the parties' intentions. *Texas Instruments,* 922 F.2d at 815.

HUD's central role here in the HUD mortgage insurance process is graphically illustrated in *A Practical Guide To Low- and Moderate-Income Housing*, published in 1972 (the "*Guide*"), contemporaneous with the creation of most of the mortgages that are the subject of this case and other pending litigation in the Court of Federal Claims. *See* Guide at 3:1ff, App. xv, *et seq.*[3] The *Guide* is important, because it provides a contemporaneous explanation of the parties' understanding of their contractual undertakings, before a dispute concerning the 20-year prepayment provision arose. As the Federal Circuit explains, "[o]ne may not ignore the interpretation and performance of a contract . . . before a dispute arises." *Alvin Ltd. v. United States Postal Service*, 816 F.2d 1562, 1566 (Fed. Cir. 1987); *KMS Fusion, Inc. v. United States*, 36 Fed. Cl. 68, 77 (1996) (to determine parties' intent, court should examine all "relevant circumstances . . . including the conduct of the parties before the advent of the controversy. . . .").

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3. The *Guide* was written by Charles L. Edson and Bruce S. Lane, then-partners of the firm of Frosh, Lane and Edson. Mr. Edson is counsel to the Amici filing this brief.

1. The Feasibility Stage. As described in the *Guide*, HUD formulated the entire mortgage insurance process, dictating the terms of the documents and "establish[ing] a rigid timetable for each of the stages" in that process. *Guide* at 3:1, App. v. For example, HUD issued guidance on site selection and scheduled a "pre-feasibility conference" with would-be developers, to review critical information such as the site, need and market for subsidized housing. *Guide* at 3:3, App. vii. Significantly, although the pre-feasibility conference was attended by a HUD officer, the developer and, sometimes, the developer's attorney and architect, it was not attended by the lender, who only appeared formally at the later stages of the process. *Guide* at 3:4, App. viii; *see* p. 8, below.

The *Guide* explains that a critical component of the insurance application process was the development of a management plan, governed by a "management guidebook" drafted by HUD, which

> assembles all the pertinent information, forms, and checklists that relate to management of the project. Included are such items as the *model form of lease* for use under Section 236 . . . ; the *model form of lease* for use under the rent supplement program . . . ; the application for tenant eligibility for rent supplement . . . ; a *model management agreement* . . . ; and several examples of *viable management programs*. . . .

Guide at 3:5-3:6, App. ix-x (emphases added). Thus, HUD controlled the form of all critical documents, including the leases and management agreement that the owners were allowed to use in their insured projects.

Next, the owner submitted a formal Application for Project Mortgage Insurance, designated as HUD Form 2013. *Guide* at 3:6, App. x. Relying on this and other documents provided by the owner, HUD prepared its Form 2264, the

Project Income Analysis and Appraisal, which allowed HUD "to prepare its own appraisal of the proposed project and to determine its economic feasibility." *Guide* at 3:7, App. xi. Again, HUD was not merely insuring a loan, but undertaking a full underwriting of the loan, on the basis of documents and criteria that it controlled.

Assuming HUD's analysis was favorable, HUD scheduled a "feasibility conference" to review design, marketing, site and economic feasibility issues. *Guide* at 3:8, App. xii. If the conference ended successfully, HUD would issue its "Feasibility Letter," defining cost limitations, mortgage and land value and other critical information. *Guide* at 3:9, App. xiii. The *Guide* notes that the letter designated a HUD "design representative," who "must approve the design plans for the project." *Id.*, n.10. The Feasibility Letter also set target dates which, if not met, could doom a project. The *Guide* warns that "[t]arget dates . . . are meant to be kept, and failure to do so may very well mean loss of the right to proceed to a commitment." *Id.*

2. The Commitment Stage. After the Feasibility Letter was issued, the developer had to obtain architectural drawings, and select a contractor, among other steps. *Guide* at 3:9-3:11, App. xiii-xv. When these steps were complete, the developer filed another Form 2013, in preparation for obtaining a conditional mortgage insurance commitment from HUD. *Guide* at 3:12-3:13, App. xvi-xvii.

Significantly, it was usually at this stage that the owner selected a lender to finance construction. The lender might be consulted from time to time, but seldom played a significant role in negotiations. *Guide* at 3:11-3:12, App. xv-xvi. Generally, throughout the mortgage insurance process, the primary negotiators were HUD and the owner. This result should not be surprising: to the extent that there was a financial risk in the loan, that risk was carried by HUD, not the lender. This accounts for HUD's control and strict

oversight over the insurance process. This relationship — intense negotiations between HUD and the owner with the lender in a tangential role — is the exact opposite of the picture painted by the appellate court, which assumed the primary legal relationship was between the owner and the lender, with HUD in a subservient posture. Because it fundamentally misunderstood the roles of the HUD, the owner and the lender, the appellate court was unable to understand their contractual relationship and the nature of HUD's commitment to allow prepayment after 20 years.

Typically, HUD issued a conditional commitment when the developer's documentation was complete. *Guide* at 3:11-3:12, App. xv-xvi. Following the issuance of the conditional commitment, the developer arranged to have the architect prepare final plans, and finalized construction lending arrangements. *Guide* at 3:12, App. xvi. The owner next updated prior filings, submitted additional documents and requested that HUD issue a firm commitment, which is the "commitment" that the appellate court referred to. *Cienega Gardens*, 162 F.3d at 1130. When the documentation was complete, the parties scheduled the "initial closing," which, as described by the *Guide*, resembles virtually all real estate transaction closings:

> At the initial closing, *like any other real estate closing*, all necessary documents are executed and delivered and HUD places its initial endorsement on the credit instrument. . . . HUD requests that all initial closing forms be submitted for review approximately 15 days prior to the initial closing. *This allows a HUD attorney to check for any errors or omissions that could cause a delay in closing*. In addition, especially for the inexperienced developer, HUD advises that a mock closing, or pre-closing conference, be held several days before the real one. *In this way each participant learns in advance what is expected of him.*

Guide at 3:13, App. xvii (emphases added). At the initial closing, attendees included the HUD attorney, "who directs the proceedings by calling for the desired forms," a representative of the lender, a representative of the developer, the developer's attorney and contractor, and the local HUD office director, who actually endorsed the note. The *Guide* describes HUD's direct control of these proceedings:

> Upon entering the closing room, the participants sign an attendance list, which becomes part of the record of the proceedings. *Most HUD offices assign the participants seats, and they are not expected to wander about during the closing.* The HUD counsel conducts the proceedings by calling for each form . . .

Guide at 3:14, App. xviii (emphases added). Thus, HUD did not merely dictate the content of the papers. Its control went so far as to actually assigning the parties' seats and maintaining discipline.

Significantly, it was only at this time that the familiar documents that the appellate court described — the Regulatory Agreement and the deed of trust note — were presented, along with a battery of other transactional documents that "collectively . . . form the heart of the transaction." *Guide* at 3:17, App. xviii-xxi. If all papers were in order, the local HUD officer issued HUD's firm commitment and initial endorsement of the note and the initial request for mortgage advance was presented to HUD. These initial advances usually covered architect and attorneys fees, HUD's 3 percent commitment fee, and HUD's inspection fees. At that point, the project construction started, with HUD inspecting the construction's progress and the owner developing tenant selection and assignment criteria. *Guide* at 3:18-3:20, App. xxii-xxiv.

3. The Final Closing Stage. When construction was nearly complete, the parties prepared for final closing, which resulted in the final endorsement of the mortgage insurance. *Guide* at 3:20, App. xxiv. Again, the familiar closing team is assembled — "attorneys for the mortgagee, mortgagor, and HUD and officials of the mortgagee, mortgagor, contractor, title company, and HUD" — and final documents are submitted to HUD. *Guide* at 3:21, App. xxv. Finally, as the *Guide* explains,

> If these actions have been acceptably accomplished and all commitment conditions have been complied with, the note will be endorsed by an authorized HUD official. The endorsement states that "A total sum of $____ has been approved for insurance hereunder by the Commissioner," and bears the signature of the "Agent" with the date endorsed.

Guide at 3:23, App. xxvii. At this point, the development period is complete and the project's mortgage insurance in place.

Virtually ignored by the appellate court, the mortgage insurance process demonstrates that HUD was not an isolated player in the Programs, but the ringmaster, setting schedules, creating forms, determining every phase of the insurance application process, and playing the tune to which all the private participants danced.

C. The Mortgage Insurance Process Explains The Parties' Understanding of The Relation Between the Contract Documents.

Properly understood, the mortgage insurance process discloses the full intent and understanding of the parties in much richer detail than the appellate court's surgical analysis of the regulatory agreement and the deed of trust note. As this narrative shows, these documents cannot be considered as separate and divisible instruments, any more than HUD

can be removed from the process. Rather, these documents were elements in a much larger and more complex process, dictated and controlled solely by HUD.[4] Prior to the time when the present dispute arose, HUD, the owners and the other parties understood that the Regulatory Agreement, the deed of trust and the other documents were all components of the elaborate and detailed insurance process.

The appellate court's treatment of the Regulatory Agreement is a good example of its mistaken understanding of the parties' intent. In its opinion, that court concluded that the Regulatory Agreement was essentially an isolated and separate agreement between the owner and HUD, which contained no mention of prepayment. *See* 162 F.3d at 1132 ("We start from the premise that the United States . . . was a named party to only one contract . . . , that contract being the regulatory agreement"). In fact, the Regulatory Agreement was created at the time of the initial closing — approximately midway through the insurance process — and was an integral step to the overall insurance program. HUD needed to assure that the owner would agree to its program requirements, such as HUD administrative scrutiny, tenant selection criteria, rent restrictions, and so on, because at approximately the same time, HUD would insure the first draw on the construction loan. *See* pg. 12, above. Thus, the Regulatory Agreement was not, as the appellate court seemed to feel, an unrelated and idiosyncratic agreement between HUD and the owner. *Rather, it was an essential predicate to*

4. The appellate court also failed to acknowledge "the common-law rule of contract interpretation that a court should construe ambiguous language against the interest of the party that drafted it." *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 62 (1995); *Hills Materials Co. v. Rice*, 982 F.2d 514, 516-517 (Fed. Cir. 1992) (Mayer, J); *Fort Vancouver Plywood Co. v. United States*, 860 F.2d 409, 414 (Fed. Cir. 1988). There is no dispute that HUD created all of the mortgage insurance documents. It should not be allowed to escape liability here by arguing that its own documents do not create a binding contract.

the provision of mortgage insurance. HUD's final endorsement to the actual deed of trust note that carried the prepayment rider can be seen merely as a final ratification of a multi-party agreement made at the time of the initial endorsement.

The appellate court demonstrates its misunderstanding of the parties' intent when it states that "it was the Owner, not HUD, that assumed obligations under the regulatory agreement." 162 F.3d at 1132. That statement cannot on its face be true, because it would mean that the regulatory agreement was void because it lacked mutual obligation. "A promise is illusory when it creates no obligation whatsoever on the part of the purported promisor." *Spacek v. Maritime Assn.*, 134 F.3d 283, 297 (5th Cir. 1998), citing Restatement (Second) of Contracts § 2, Comment e (1981). Of course, the consideration that supports the Regulatory Agreement is the provision of subsidies and mortgage insurance by HUD. If anything, the apparent lack of mutuality underscores the conclusion that the Regulatory Agreement must be read in conjunction with the loan documents that HUD endorsed, demonstrating that it was a party to the prepayment promise in the deed of trust rider.

The panel's mistaken separation of the Regulatory Agreement and the deed of trust note creates other irresolvable inconsistencies. The Regulatory Agreement clearly imposes a number of duties upon the owner, including tenant and rent restrictions. However, those restrictions only applied while the note was outstanding. HUD, the owner and the other parties all knew that the owner's obligations under the Regulatory Agreement hinged on the existence of the insured mortgage. Thus, the prepayment provision was a critical term, not just to the relation between the lender and the owner, but to the overall relation between HUD and the owner. ***The Regulatory Agreement and the note were not two separate documents but instead together established the nature and the length of the owners' obligations to HUD.***

The mortgage insurance process also demonstrates the critical importance of the firm commitment issued by HUD, a document that the appellate court glossed over. As the narrative shows, the commitment was a crucial document, because it permitted the parties to go to the initial closing, which in turn allowed the lender to make initial advances without which construction could not commence. *See* pp. 10-12, above. As its name implies, the commitment was just that — a promise to insure the mortgage, so long as subsequent conditions were met. Significantly, in making these promises, HUD offered its insurance under "the Regulations . . . now in effect." *See* Commitment For Insurance of Advances, App. xxviii. But, as Judge Archer's dissent correctly pointed out, *HUD's then-existing regulations expressly allowed for prepayment of the owners' mortgages after 20 years.* 162 F.3d at 1139; 24 C.F.R. § 221.524(a)(ii) and 236.30(a)(i)(1970). Thus, in offering to extend mortgage insurance subject to conditions subsequent, HUD thus bound itself to abide by the 20-year prepayment provision.[5] At the very least, the commitment demonstrates that all the parties at the time understood that the owners enjoyed a 20-year prepayment right, reflected both in HUD's own regulations and ultimately, the deed of trust note signed by the parties and endorsed by HUD.

Indeed, it is hard to imagine how the parties could evidence their mutual agreement to the prepayment provision any more clearly. It would be inappropriate, in light of this structure, for HUD and the owner to include a prepayment provision in the Regulatory Agreement, for example, since that document presumably was not intended to alter the

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5. The only alternative view — that HUD merely bound itself to observe the 20 year prepayment rule for so long as it chose to abide it — exemplifies "an absolutely classic description of an illusory promise," according to Justice Scalia. *United States v. Winstar Corp.*, 518 U.S. 839, 921 (1996) (Scalia, J., concurring in the judgment).

lenders' rights. Likewise, it would not be expected that HUD would be a full signatory to the deed of trust note, since it was not obliged to pay the lender except in the event of the owner's default. Instead, it endorsed the note, signifying, as the narrative shows, the successful completion of the mortgage insurance process and, more importantly, its agreement to provide its insurance *pursuant to the terms of the deed of trust note, the form of which it dictated.* In looking for a three-way agreement, expressly stating HUD's consent to the prepayment provision, the appellate court sought something that the parties knew was unnecessary and, as a matter of documentation, fully established elsewhere.

D. The Parties' Own Statements Underscore HUD's Consent to the Prepayment Provision.

As noted above, the parties' own conduct, prior to the eruption of a dispute, is strong evidence of the nature of their contractual intent. *Alvin Ltd.*, 816 F.2d at 1566. The fact that the parties made few contemporaneous references to the prepayment provision is itself indication that the parties understood and abided by the rights provided in the deed of trust note's rider. Nevertheless, the record shows that there is no dispute that at all relevant times, the parties recognized that right.

First, and most obviously, HUD's own regulations were an apparently unmistakable signal that HUD not only agreed to the prepayment provision, but required that all loans subject to its mortgage insurance carry the required prepayment language. *See* pg. 16, above. There can be few better examples of the parties' intent that these express regulations, the terms of which were swept into the parties' agreement by the commitment and the subsequent endorsement.

In fact, as Judge Archer points out, HUD has never rebutted the Petitioners' claim that the parties understood that HUD contracted to abide by the prepayment provision.

See 162 F.3d at 1137. If the appellate court is correct in its conclusion that there is no factual dispute (162 F.3d at 1130), one fact that clearly is not disputed is the parties' contemporaneous understanding of the prepayment provision.

Even later, however, when the first issues arose about prepayment, HUD did not actually challenge the existence of a contractual right to prepay:

> *It is our position that there was a contractual relationship between the Federal Government and private owners*, that was negotiated at that time, and at this point in time there is an arm's length transaction that cannot be changed.

Loss of Subsidized Multifamily Housing Units: Hearings Before the Subcomm. on Housing and Community Development of the House Comm. on Banking, Finance and Urban Affairs, 99th Cong., 2d Sess. 17 (1986) (testimony of R. Hunter Cushing, Deputy Assistant Secretary for HUD's Multifamily Housing Programs) (emphasis added). As Mr. Cushing admitted, the prepayment provision was intended "to get [the developers] involved in the program . . . to try and convince them to get in the program." *Id.* at 18. In light of Mr. Cushing's unambiguous declaration in 1986 that a contract existed, it shocks the conscience that the government now argues that a contract did not exist.

The Conference Report on LIHPRHA also reported that "the House Amendment established a mechanism *for recognizing the property owners' contractual interest* while not paying overly generous benefits to owners." H.R. Rep. 101-943, 101st Cong. 2d Sess. (1990) at 459 (emphasis added). Addressing then-pending legislation, two senators reflected the same understanding of the owners' contractual interest. As Senator William L. Armstrong (R. Colo.) explained, "[w]hen you curtail that [contract right], particularly when it is a contract right with a sovereign, it

might well be that some court, a circuit court or the Supreme Court might find that to be unconstitutional." 136 Cong. Rec. S14090 (daily ed. Sept. 27, 1990) (statement of Sen. Armstrong). Similarly, Senator Howell Heflin (D-Ala.) warned that "the very notion of unilaterally abrogating a contract, which has been adhered to by one party for 20 years, flies in the face of the law." 136 Cong. Rec. S14091 (daily ed. Sept. 27, 1990) (statement of Sen. Heflin).[6]

While the Amici agree that these statements cannot themselves create a contractual relationship if it did not exist earlier, *they clearly demonstrate that as late as 1990, the Federal government itself admitted that a contract existed between the owners and HUD allowing them to prepay their mortgages after 20 years*. Certainly, Secretary Kemp would not have made his statements (*see* n. 6) unless he believed that there was a true contractual arrangement, and Congress would not have committed over a billion dollars of the national fisc to compensate owners for contract violations if they believed that the parties never had a contract in the first place.

Indeed, even in later litigation involving ELIHPA, HUD admitted that a contract to allow for prepayment after 20 years existed between HUD and the owners. *Thetford Properties IV Limited Partnership v. Department of Housing and Urban Development*, 907 F.2d 445 (4th Cir. 1990). In

6. The appellate court dismissed portions of the legislative history of the prepayment legislation, ELIHPA and LIHPRHA, as "after-the-fact" declarations which cannot create a contractual relationship. 162 F.3d at 1134. In fact, the statements made at the time that the legislation was enacted are extraordinarily important. For example, Jack Kemp, then-Secretary of HUD, explained the need to "come up with a . . . proposal that would solve [the prepayment] problem without either continuing the moratorium or *having us violate the terms of the contract*." *HUD Legislative Proposals: Hearing Before the Subcomm. on Housing and Community Development of the House Comm. on Banking, Finance and Urban Affairs*, 101st Cong., 2d Sess. 42 (1990) (emphasis added).

that case — which focused on issues of exhaustion of administrative remedies — HUD conceded that the plaintiff-owners, *"did enter into contracts with HUD in 1966 and 1968"* in connection with their Section 221(d)(3) mortgages. Brief of United States at 24 (App. iii) (emphasis added). Thus, as late as 1990, HUD would not deny the obvious and dispute that the owners had a contractual right to prepay.[7]

After inducing the owners to enter into these contracts with a promise to prepay after 20 years, and maintaining that position steadfastly through that 20 year period until the very eve of the filing of the present litigation, the government should not ask this Court to sanction its unprincipled change of position.

CONCLUSION

By concentrating improperly on individual documents and ignoring the intent of the parties evidenced by the "totality of circumstances" surrounding the mortgage insurance process, the appellate court reached a conclusion that would have startled anyone attending a final closing of an insured loan and that was adopted by the government only when the case began. To prevent an enormous injustice, the Court should grant the Petition.

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7. The appellate court here disposes of the statement in *Thetford* that the Regulatory Agreement created the contractual right for the owners to prepay as mere dictum. 162 F.3d at 1132. We now know, however, that the Fourth Circuit based its opinion on the government's brief, acknowledging that a contract in fact did exist.

Respectfully submitted,

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